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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1985

ROBERT BOGGILD and WILLIAM L. DALE,
Petitioners,

v.

KENNER PRODUCTS, A DIVISION OF
CPG PRODUCTS CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

I. Does a federal supremacy doctrine based on Article I, Section 8 of the Constitution require that a licensee be permitted to escape further payment of royalties by claiming *per se* invalidity of the license agreement beyond the expiration of a subsequently issued patent covering the subject matter of the license, where the royalties are based on trade secrets and technical services and the leverage of a potential patent monopoly did not influence the making of the agreement?

II. In reviewing the granting of summary judgment for the licensor, may the Court of Appeals make findings of fact concerning the parties' use of the leverage of a potential patent, and thereupon hold the agreement "*per se*" invalid beyond the expiration of such a patent?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners respectfully request that a Writ of Certiorari be issued to review the decision and judgment of the United States Court of Appeals for the Sixth Circuit entered on November 13, 1985, which reversed the decision of the United States District Court for the Southern District of Ohio, Western Division, granting summary judgment in favor of the Petitioners.

OPINIONS BELOW

The opinion of the Court of Appeals is contained in the Appendix at 1a, and is reported at 776 F.2d 1315. The opinion of the District Court granting summary judgment is contained in the Appendix at 12a, and is reported at 576 F. Supp. 533.

JURISDICTION

The judgment of the Court of Appeals was entered on November 13, 1985. A Petition for Rehearing was timely filed by the Petitioners on November 26, 1985. The Petition for Rehearing was overruled on January 2, 1986. Jurisdiction to review the judgment of the Sixth Circuit in this cause by a Writ of Certiorari is conferred on this Court by 28 U.S. Code § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Article I, Section 8, U.S. Constitution:

> "The Congress shall have Power . . . To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their repective Writings and Discoveries;"

35 U.S.C., Section 154:

> "Every patent shall contain a short title of the invention and a grant to the patentee, his heirs or assigns, for the term of seventeen years, subject to the payment of fees as provided for in this title [35 USCS §§ 1 et seq.], of the right to exclude others from making, using, or selling the invention throughout the United States, referring to the specification for the particulars thereof. A copy of the specification and drawings shall be annexed to the patent and be a part thereof."

STATEMENT OF THE CASE

The Petitioners are the inventors of a toy extrusion device designed to be used with the modeling compound Play-Doh. On January 18, 1963, the Petitioners entered into a trade secret licensing agreement with Kutol Products, Inc., which at that time was manufacturing Play-Doh. The Respondent, Kenner Products, a Division of CPG Products Corp. (hereinafter "Kenner"), is the successor-in-interest to the rights and liabilities of Kutol Products, Inc. under the said trade secret licensing agreement. CPG Products Corp. is a Delaware corporation whose principal place of business is in Minnesota. Kenner has its offices and some of its manufacturing facilities in Cincinnati, Ohio.

This action was commenced in the Common Pleas Court of Hamilton County, Ohio, on March 24, 1983. In their complaint in the state court, Petitioners alleged in substance that Kenner had shortchanged the Petitioners on royalty payments since it had first begun marketing Petitioners' extrusion device in 1971, by making certain unilateral, unauthorized deductions from the sale price of the extruder before applying Petitioners' royalty rate of 5%.

In response to the state court complaint, Kenner petitioned for removal of the action from the state court to the United States District Court for the Southern District of Ohio, Western Division, at Cincinnati. The basis asserted by Kenner for federal jurisdiction was diversity of citizenship, 28 U.S.C. § 1332. Upon removal of the action to the District Court, Kenner filed an Answer and Counterclaim in which it asserted, as its eighth affirmative defense and its second counterclaim, the contention that as of August 9, 1983, the date of expiration of the last-to-expire patent on the extrusion device, Kenner would be free of the obligation to pay royalties under the License Agreement, even though the agreement, by its terms, would not expire until January 18, 1988. Petitioners moved for judgment on the pleadings with respect to the sufficiency of Kenner's eighth affirmative defense and second counterclaim; and Kenner in turn moved

for summary judgment, asserting that it was entitled to judgment as a matter of law on that defense and counterclaim.

On December 15, 1983, the District court issued its opinion and order sustaining Petitioner's motion and overruling the motion of Kenner. The District Court refused to certify its December 15, 1983 ruling for immediate appeal, under either rule 54(b) Federal Rules of Civil Procedure, or 28 U.S.C. § 1292(b). Thereafter, a settlement was reached between Kenner and the Petitioners with respect to the claims for past underpayment of royalties, and a consent decree was entered into, which was placed of record on June 12, 1984. Among other things, the consent decree certified the December 1983 ruling as final and appealable.

From that judgment, Kenner took its appeal to the United States Court of Appeals for the Sixth Circuit by Notice of Appeal filed on June 15, 1984. After briefing and argument, the Court of Appeals rendered its opinion and judgment on November 13, 1985, reversing the order of the District Court granting partial summary judgment for the Petitioners and remanding "for proceedings consistent with this opinion." In its opinion, the Sixth Circuit also reviewed the subject licensing agreement in the light of its interpretation of *Brulotte* v. *Thys Co.*, 379 U.S. 29, 85 S.Ct. 176 (1964), and held that the agreement was unlawful *per se* beyond the expiration dates of the patents. A timely Petition for Rehearing was denied on January 2, 1986.

In the late 1950's and early 1960's, Joseph McVicker, the owner of Kutol Products, Inc., who had been making and marketing a brand of wallpaper cleaner, decided that his product would also make a good modeling compound. He began to make his compound in a number of bright colors, with a more pleasant scent, and called it Play-Doh. The trouble with marketing a modeling compound was that whether it was Play-Doh or clay, most children soon tired of playing with it, unless they had some artistic talent, because most children did not have the ability or the imagination to create interesting or exciting shapes with it.

In order to make Play-Doh more marketable, McVicker

turned to Boggild and Dale, who agreed to submit designs for a number of simple devices by which children could turn Play-Doh into unusual and interesting shapes and forms. One of the first, and certainly the most successful, of the devices which Boggild and Dale invented for McVicker and Kutol Products, Inc. was the Play-Doh extruder marketed under the name "Fun Factory, Jr." A copy of a pictorial representation of the extruder is provided in the Appendix to this Petition, page 55a.

The trade-secret License Agreement between Boggild and Dale as licensors and Kutol Products, Inc. as licensee (Appendix, pp. 27a-38a) was a comprehensive document. Not only did it grant to Kutol the right to make, use, and sell the extrusion device as designed by Boggild and Dale and disclosed to McVicker, but it also provided that Boggild and Dale would:

(1) Provide engineering drawings (Article V); (2) Provide working models for demonstration to potential customers (Article V); (3) Participate in negotiations to obtain suppliers for parts (Article V); (4) Work with parts manufacturers and/or assemblers until the product was established in satisfactory repetitive manufacture (Article V); (5) Redesign the device to eliminate any design or mechanical faults (Article V); (6) Establish the standards for manufacture of the device (Article V); (7) Communicate technical know-how, data or other information pertinent to the extrusion device at that time in Petitioners' possession or "which may hereafter within the term of this Agreement be acquired by B and D" (Article V); (8) Cause a patent infringement search to be made (Article XIV); (9) submit an opinion regarding the likelihood of infringement (Article XIV); (10) File mechanical and design patent applications (Article II).

At the time that the License Agreement was negotiated and entered into, there was no patent application pending. There was in the agreement no requirement for an opinion of counsel concerning the likelihood that any patents would issue. While the agreement required Petitioners to file and prosecute patent applications, the royalty terms of the agreement were expressly made independent of whether or not the

extrusion device was patentable. Thus, Article VI(f)(1) of the License Agreement provided that the royalty rate would escalate from 3% to 4% to 5% on the basis of the number of units of the extruder sold by the licensee—not on the basis of whether any patent was issued. Once 500,000 units were sold, the royalty rate was to be 5%. Article VI(g) of the License Agreement provided that the payment of such royalties was to continue

> "regardless of whether or not the filing of the patent applications contemplated in Article II hereof results in the issuance of a patent or patents."

In return for the assignment of rights and the other benefits and considerations agreed upon and described above Kutol Products, Inc. agreed to pay Boggild and Dale royalties for a period

> "which shall run to the full end of the term or terms of any Letters Patent that may issue on or as a result of the application or applications referred to in Article II hereof, or for a period of 25 years, whichever is longer, and shall thereupon terminate" (Article XIII(d)).

The term of the License Agreement thus did not *necessarily* extend for a period beyond the life of any patents which might issue. At the time the agreement was negotiated, it was not unlikely that the patent application contemplated in Article II could be pending for eight years or more before any patent was issued, with the result that the minimum 25 year term of the agreement would be shorter than the patent lives. (Play-Doh itself had taken nine years to receive a patent.)

As agreed, the Petitioners filed mechanical and design patent applications, which resulted in the issuance of Design Patent No. 200,480 on March 2, 1965, and Mechanical Patent No. 3,264,685 on August 9, 1966.

Joseph McVicker was not influenced in his negotiation of the royalty terms of the licensing Agreement by the expectation that any patents would issue. In his deposition taken in California on December 19, 1985,[1] Mr. McVicker testified that the likelihood that the device would be patented did not affect his willingness to pay royalties for a term of at least 25 years:

> Q: Did the thought that this device may be patentable influence in any way, your desire to pay royalties for the use of the device and to pay those royalties for that period of time?
>
> A: The patent and the application and the assertion of the patent, and the possible issuance of a patent, did not determine my making a deal with Boggild. What determined it was a whole package, which included their giving me technical and manufacturing assistance, solving manufacturing problems, taking responsibility to search infringement, the cost of filing for an application and seeing it through without any cost or liability to me; and that's the deal I made with them. (McVicker Deposition, p. 12)
>
> * * *
>
> Q: The agreement contained certain provisions with respect to patent and patent applications. Given that, can you tell us what, if any, role the expecta-

[1] When it became apparent upon the issuance of the Sixth Circuit's opinion that an issue of fact concerning the parties' "expectations that a valid patent will issue" may be dispositive of the case, permission was obtained from the District Court under Rule 27(b) Federal Rules of Civil Procedure, to take Mr. McVicker's deposition. A copy of that deposition appears on pages 39 through 54 of the Appendix of this Petition.

tion that a patent might issue for this device played in your willingness to pay royalties for the use of the device?

A: That's a long question. Please rephrase it simply for me.

Q: Let me try Did the likelihood that this device would be patented affect your desire to pay royalties for it?

A: No, I couldn't wait for that. The patent process is lengthy, and, I think, fairly worthless. It took me nine years to get a patent on Play-Doh. I don't know how long it took to get a Fun Factory, Jr. patent, but if I waited for that, someone else may have invented a toy to take its place. . . .

* * *

Q: When did you have—did you have any idea when you signed that agreement, that this toy was going to be patented?

A: I don't know, but I certainly asked, after this bad experience that I had if I would be protected any way I could be protected, and they should at least see if they could get a patent protection, and protection is an additive, but it is not determinative for me. What determines it is, can I sell it and can I get it to the market first? (McVicker Deposition, pp. 10-11)

ARGUMENT

I. REASONS FOR ALLOWANCE OF THE WRIT OF CERTIORARI.

This is a clear-cut case of a licensee cloaking itself in the mantle of the public's interest in the free exploitation of ideas in order to escape having to pay royalties on a license agreement its predecesssor freely bargained for. This masquerade is possible only because the Circuit Courts have failed to analyze and properly apply this Court's holdings in *Brulotte* v. *Thys Co.*, 379 U.S. 29, 85 S.Ct. 176 (1964), and *Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 257, 99 S.Ct. 1096 (1979), and because this Court has so far not seen fit to set them straight—presumably because the right case hasn't yet come along.

This is the right case. Kenner products, the corporate successor to the market-savvy entrepreneur Joe McVicker, has for years reaped profits from the market position established by McVicker for Play-Doh and for the toy extrusion device invented by the Petitioners. The subject trade-secret license agreement enabled McVicker to be first in the marketplace with the extruder, whose marriage with Play-Doh produced millions of sales. In return for this opportunity, and for the technical services of the Petitioners in starting up and continuing production, McVicker agreed to pay the Petitioners royalties for a minimum term of 25 years—regardless of whether or not the extruder was patentable.

The agreement required patent applications to be made, however, and patents were issued. Taking its cue from the *"per se"* language of *Brulotte* and from certain *dicta* by this Court in *Aronson*, Kenner says the expiration of those patents excuses it from paying further royalties.

The District Court looked behind the *"per se"* language of *Brulotte* and saw that it couldn't be applied to an agreement made when no patent existed or was even applied for. The Sixth Circuit Court of Appeals, following the Eleventh Circuit in *Pitney Bowes* v. *Mestre*, 701 F.2d 1365 (11th Cir. 1983), *cert. den.* 104 S.Ct. 239 (1983), tried to apply a *per se*

rule, but ended up making findings of fact on whether the Petitioners used the leverage of a potential patent monopoly to negotiate the royalty term.

The law in this important area of intellectual property licensing is now in a state of confusion which only this Court can correct. *Brulotte* and *Aronson*, together with *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470, 94 S.Ct. 1879 (1974), clearly mean that a trade secret license agreement can be invalidated only if the leverage of a patent monopoly is used to extend royalty payments for patented subject matter beyond the life of applicable patents. Only then is there a conflict between state and federal law. But this leverage issue is a question of fact, not a *per se* issue of law. As the Circuit Courts are applying *Brulotte*, however, the mere presence of a patent, covering the subject matter of a license agreement, no matter how inconsequential it is to the bargain, may be used to destroy the bargain after the fact. For example, if for the sake of completeness the parties decide to recite a patent in an agreement covering trade secrets, and that patent has but three months left in its term, the Sixth Circuit's application of a *per se* rule of invalidity would require that the license agreement expire in three months, contrary to the wishes of the parties, simply because the patent is there.

Such results artifically restrict the ability of inventors and licensees to bargain freely the value of inventions in the marketplace. Inventors are also thereby discouraged from applying for patents, if the patent can be used to limit royalties which the free market for new ideas will otherwise bear.

This case presents to the Court for the first time a clear-cut set of facts upon which the Court can dispel the confusion and settle, once and for all, the issue of what circumstances require an agreement to pay royalties to be voided by overriding public policy inherent in the patent laws. This case contains the following elements which have not been present in any prior case this Court has had the opportunity to review:

(1) No pending patent application at the time the agreement was made;

(2) Patent issuance and expiration during the term of the agreement;

(3) Substantial technical services rendered by the licensors in addition to the licensing of the invention; and

(4) Affirmation, both in the terms of the agreement and in available testimony, that the parties assigned no value, in terms of royalties, to the potential issuance of a patent covering the invention.

The Sixth Circuit's attempted application of a *per se* rule of invalidity was inappropriate here and in conflict with this Court's reasoning in *Brulotte*, *Kewanee*, and *Aronson*, as noted above and as more fully discussed below.

In addition, the Sixth Circuit clearly departed from the accepted and normal course of judicial proceedings by making findings of fact on the patent-leverage question, and thereupon purporting to find the agreement unlawful "*per se.*"

The confusion inherent in the Sixth Circuit's decision may indeed have put this case into an unreviewable posture at this time. Since there are no findings of fact by the proper trier of the facts on the issue of patent leverage, the appropriate disposition of the case may be to remand it for trial, by summary disposition under Rule 23.

II. FIRST QUESTION PRESENTED FOR REVIEW.

Does a federal supremacy doctrine based on Article I, Section 8 of the Constitution require that a licensee be permitted to escape further payment of royalties by claiming per se invalidity of the license agreement beyond the expiration of a subsequently issued patent covering the subject matter of the license, where the royalties are based on trade secrets and technical services and the leverage of a potential patent monopoly did not influence the making of the agreement?

Disposition of this case depends, in the first instance, on the interpretation of *Brulotte* v. *Thys Co.*, *supra*, and its "*per se*" language. In *Brulotte*, the owner of various patents for hop picking sold machines incorporating the patents for flat sums, and issued licenses for the use of the patents as incorporated into the machines, requiring the payment of royalties for the licenses over and above the purchase price of the machines. The contracts in issue were negotiated either during the life of the patents involved or following the expiration of some of them. None of the contracts were negotiated prior to issuance of or application for patents. The contracts provided for the payment of royalties beyond the expiration dates of the patents.

With patents in effect when the *Brulotte* agreements were made, it seems to have appeared to this Court that any projection of the obligation to pay royalties was "a tell-tale sign that the licensor was using the licenses to project its monopoly beyond the patent period." 85 S.Ct. at p. 179. Under those circumstances, this Court found itself "unable to conjecture what the bargaining position of the parties might have been and what resultant arrangement might have emerged had the provision for postexpiration royalties been divorced from the patent and *nowise subject to its leverage.*" 379 U.S., at 32; 85 S.Ct. at 179, emphasis supplied. Clearly, it is the use of the patent monopoly to leverage an obligation to pay royalties beyond the patent's monopoly period, which this Court found

unlawful in *Brulotte*. In that case, because the patents were in effect at the time the license agreements were negotiated, it may have been difficult to conceive of the negotiations being conducted without the leverage of the patent monopoly having an influence. Therefore, this Court concluded "that a *patentee's* use of a royalty agreement that projects beyond the expiration date of the patent is unlawful *per se*." 379 U.S., at 32; 85 S.Ct. at 179, emphasis supplied.

The "*per se*" rule of *Brulotte* is thus limited to the case presented there, where the owner of existing patents uses the leverage of the patent monopoly to project royalty payments beyond the life of the patents. Where the patents are in existence at the time of negotiations, the influence of their leverage upon negotiations may be rebuttably presumed.

But it is clear that what renders an agreement invalid under the *Brulotte* rule is the leveraging of the patent monopoly to exact royalties beyond the expiration date of the patent; not simply the fact that the royalty obligation under the agreement continues after patents expire. Thus, this Court said in *Brulotte:*

> "A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly. But *to use that leverage to project those royalty payments beyond the life of the patent* is analogous to enlarging the monopoly of the patent by tying the sale or use of the patented article to the purchase or use of unpatented ones." (379 U.S. at 33; 85 S.Ct. at 179 (emphasis supplied).)

Where there are no issued patents at the time of negotiations, but only a pending patent application or a promise to apply for a patent, it is evident that something other than a potential patent monopoly may influence the parties to enter into the License Agreement. It is probable that in most cases, as in the present case, that influence is the desire of the licensee to obtain the right to be the first in the marketplace to exploit the novelty of the licensed invention. In such a case,

the parties to the agreement may or may not be influenced in their negotiations by the expectation that a patent will issue. There can therefore be no *per se* presumption of invalidity simply because royalty payments may be provided to extend beyond the expiration date of patents which may later issue. The District Court recognized this fact in its decision as follows:

> "We recognize that, regardless of whether an application has been made, one might improperly leverage the possibility that the patent might issue if the parties believe there is a substantial likelihood that a patent might issue. Under those circumstances, however, application of a *per se* rule is inappropriate. We hold therefore, that the *per se* rule of *Brulotte* does not extend to the case where no patent application has been made at the time the agreement is negotiated even if an application is contemplated." 576 F. Supp. at 536-537.

This Court also recognized the limitation of the *per se* rule of *Brulotte* in the opinion of the Court in *Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 257, 99 S.Ct. 1096 (1979). In that case, a trade secret license for a simple, novel, keyholder device was negotiated while a patent application for the device was pending. Unlike the present case, no patent was later issued for the device, and the agreement provided for a reduced royalty in the event that a patent did not issue. This Court held the *Aronson* agreement to be enforceable, holding first that the enforcement of the agreement did not present a conflict with federal patent law, and second, that enforcement of the royalty agreement was "consistent with the principles treated in *Brulotte* v. *Thys Co.*":

> "There, we held that the obligation to pay royalties in return for the use of a patented device may not extend beyond the life of the patent. The principle underlying that holding was simply that the monopoly granted *under a patent* cannot lawfully be used to 'negotiate

> with the leverage of that monopoly'." 440 U.S. at 264-65; 99 S.Ct. at 1100 (emphasis by the Court).

With respect to the leverage afforded by a potential patent, this Court noted in *Aronson:*

> "No doubt a pending patent application gives the applicant some additional bargaining power for purposes of negotiating a royalty agreement. The pending application allows the inventor to hold out the hope of an exclusive right to exploit the idea, as well as the threat that the other party will be prevented from using the idea for 17 years. *However, the amount of leverage arising from a patent application depends on how likely the parties consider it to be that a valid patent will issue.* 440 U.S. at 265, 99 S.Ct. at 1100-101 (emphasis supplied).

This language of the Chief Justice's opinion is wholly inconsistent with any notion that a trade secret licensing agreement negotiated with a patent application pending can be unlawful *per se* just because it may extend beyond the life of a patent which might later issue. *A fortiori*, there can be no *per se* invalidity where, at the time of negotiations, no patent has even been applied for and no infringement search has been undertaken, even though the parties contemplate the doing of both. Plainly, the leverage of a *potential* patent monopoly must be *proven* to have influenced the royalty term of the agreement, in order for the *Brulotte* rule to invalidate it. In such case, however, the agreement is not invalid *per se:* it is invalid only to the extent of the leverage exerted by the potential patent monopoly.

Underlying the *Brulotte* rule is the principle that trade secret licensing agreements may not be enforced to the extent that they conflict with the policies and purposes of federal patent law. Although detailed discussion and explication of this conflict issue did not appear in the *Brulotte* opinion, but was left to later decisions of this Court in *Kewanee Oil Co.* v. *Bicron Corp.* 416 U.S. 270, 94 S.Ct. 1879 (1974), and *Aron-*

son v. *Quick Point Pencil Co.*, *supra*, it is clear that an instance of such conflict occurs where a patentee uses the leverage of his patent to negotiate a licensing agreement which provides for the payment of royalties after the expiration of the patent, and the patentee seeks to enforce the extended royalty obligation by invoking state contract law.

It is *the leveraging of the patent monopoly* to extend the royalty payments which sets up the conflict. As this Court noted in *Kewanee* and *Aronson*, there is no conflict between state trade secret licensing law and federal patent law *per se*. Trade secret licensing law and patent law, by this Court's analysis in those cases, can coexist in the same agreement, so long as the state law does not interfere with the objectives of the patent law. (*See*, *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. at pp. 479-80; and *Aronson* v. *Quick Point Pencil Co.*, 440 U.S. at pp. 262-63, 99 S.Ct. at pp. 1099-1100.) The District Court followed this Court's analysis and determined that enforcement of the existing licensing agreement did not *per se* present a conflict between state law and federal patent law and policy, even though, in this case, patents did issue. 576 F. Supp. at 537-39. The Sixth Circuit, however, in its opinion in this case, failed to address that analysis.

In *Pitney Bowes* v. *Mestre*, 701 F. 2d 1365 (11th Cir. 1983) *cert den.*, 104 S.Ct. 239, the Eleventh Circuit seemed to recognize that even though a patent issues after a license agreement is entered into, the issuance of the patent does not itself set up a conflict between patent law and trade secret law; rather, "when a patent issues, the *potential* exists for direct conflict between federal patent law and state trade secret law." 701 F.2d at 1372, emphasis supplied. In footnote 12 of the Eleventh Circuit's opinion in *Mestre*, 701 F.2d at 1372-73, the Court noted that it is the improper use of the patent monopoly leverage which sets up the conflict in such a case:

> "This does not mean that parties cannot agree to license both trade secrets and patent rights *on patents actually issued*. As the Court in *Kewanee* noted, the purposes of

> patent protection and trade secret protection usually are entirely different, and the enforcement of trade secrets need not necessarily undermine federal patent policy, (citations omitted) but *if and when their purposes conflict directly*, federal supremacy requires that federal patent law determine the rights under the agreement." (Emphasis supplied.)

In concluding that footnote, the Eleventh Circuit recognized that even where a patent issues, there may be no conflict between trade secret law and patent law if it can be shown that the leverage of a patent monopoly was not used to exact trade secret royalty payments beyond the life of the patent:

> Indeed, the Supreme Court has never addressed the question whether a hybrid agreement in which patents issue can ever survive the expiration of the patents. The Court in *Brulotte*, however, applied a *per se* rule to agreements containing the same terms before and after the patent expires because it was 'unable to conjecture what the bargaining position of the parties might have been' had no patent been involved. 379 U.S., at 32, 85 S.Ct., at 179. The implication of this language is that, if a patent owner can prove that he did not use his patent monopoly leverage to exact reduced post-expiration trade secret payments, then there would be no direct conflict with federal law and the agreement would be enforced." 701 F.2d at 1373, n. 12.

Both the Eleventh Circuit in *Mestre* and the Sixth Circuit in this case emphasized the fact that in *Aronson*, no patent had issued, and relied upon certain *dicta* in this Court's *Aronson* opinion as an indication of what this Court's opinion would be if, as in the present case, it were faced with a fact situation which included the issuance of a patent during the term of the licensing agreement. See, *Mestre*, 701 F.2d, at p. 1372; and *Boggild*, 776 F.2d, at p. 1319-1320, footnote 5. The full quotation of this Court's *dicta* appears in *Aronson*, 440 U.S. at 263-64, 99 S.Ct. at 1100:

> "Finally, enforcement of this agreement does not discourage anyone from seeking a patent. Mrs. Aronson attempted to obtain a patent for over five years. It is quite true that had she succeeded, she would have received a 5% royalty only on keyholders sold during the seventeen year life of the patent. Offsetting the limited terms of royalty payments, she would have received twice as much per dollar of Quick Point's sales, and both she and Quick Point could have licensed any others who produced the same keyholder. Which course would have produced the greater yield to the contracting party is a matter of speculation; the parties resolved the uncertainties by their bargain."

These *dicta* do not necessarily indicate that this Court would hold that the issuance of a patent precludes the enforcement of a trade secret licensing agreement beyond the life of the patent, even where no leverage of an actual or potential patent monopoly was used to negotiate the royalty term. These *dicta* may equally well be read to comment on the effect of the terms of the contract. Thus, the agreement provided that Mrs. Aronson would receive a 5% royalty only if the licensed device were patented; otherwise, she would receive a reduced royalty of 2½%. The 5% royalty would be clearly contingent upon the attaining and licensing of patent rights, and therefore it could only be effective during the 17-year life of a patent. Similarly, the 2½% reduced royalty would only be payable, under the terms of the agreement, if a patent had not issued. The parties could have provided for the reduced royalty to continue after the expiration of the patent, without setting up a conflict with patent law. As this Court noted, the reduced royalty clearly was not negotiated with the leverage of a patent:

> "It is clear that whatever role the pending application played in the negotiation of the 5% royalty, it played no part in the contract to pay the 2-½% royalty indefinitely." 440 U.S. at 265, 99 S.Ct. at 1101).

If it is lawful to negotiate a reduced royalty to be applied after the expiration of a patent, clearly the issuance of the patent does not *ipso facto* establish such a conflict between the trade secret license and the patent so as to render the former invalid and unenforceable after the patent expires. If acceptance of this case for review accomplishes nothing else, presumably it will at least obviate the further necessity of speculating on the basis of *dicta* what this Court's decision would have been if a patent had issued in *Aronson*.

In *Brulotte*, applicability of the same royalty provisions before and after expiration of the patents was viewed by this Court as "a tell-tale sign that the licensor was using the license to project its monopoly beyond the patents." 379 U.S. at 32, 85 S.Ct. at 179. In *Mestre* and in the present case, the courts of appeals relied on the lack of difference in royalties before and after patent expiration as a sort of "rule of thumb" indicating invalidity of the agreement.

Evidently, in *Mestre* there was no evidence as to whether or not the pending patent applications provided leverage to influence the original licensee to agree to pay royalties for a period beyond the life of the patents. (In the present case, as the Statement of Facts reveals, such evidence is available.) Without such evidence, the Eleventh Circuit, noting no apparent allocation between patent royalties and nonpatent royalties on the face of the agreement, applied the "rule of thumb" and held the agreement invalid. In the present case, the Court of Appeals specifically relied upon the lack of allocation of royalties as an indication of improper leveraging of the patent monopoly. *See*, 776 F.2d at p. 1319.

But the key to the analysis, again, is not the *amount* of the post-expiration royalty payment, but whether the leverage of a potential patent monopoly influenced the licensee's willingness to pay that amount. Thus, in *Mestre* the Eleventh Circuit observed:

"Assuming that the value of the agreement to Pitney

> Bowes was not as high after the patents expired, it is reasonable to assume that at least some part of the post-expiration payment constituted an effort to extend payments for patent rights beyond the patent period." 701 F.2d at p. 1373.

Such assumptions are valid only in the absence of evidence to the contrary. What if it could be shown that the value of the agreement to the licensee was the same with or without patent protection? Article VI(g) of the agreement in the present case provided that the same royalties would be paid "regardless of whether or not the filing of patent applications contemplated in Article II hereof results in the issuance of a patent or patents." That provision is most appropriately viewed as a clear expression of the intent and understanding of the parties that the patentability of the extruder was immaterial to the willingness of the licensee to pay royalties. Indeed, the available evidence shows that in this case, as in *Aronson*, the primary value of the license was to enable the licensee to be first in the marketplace with a novel idea. The parties assigned a zero value to the patents.[2]

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[2] Another matter of allocation may be pertinent. It should be noted that in the present case, the licensing agreement required the licensors to provide a great deal of technical know-how and actual technical services in preparing the extrusion device for mass production. (Article V.) As the McVicker deposition reveals, Mr. McVicker left it entirely up to Boggild and Dale to handle the engineering of the extruder, for all of which work they would be compensated only through the medium of the royalty, while McVicker handled the marketing of the product. (McVicker Deposition, p. 6; Appendix, p. 43a.) There is substantial authority for the proposition that even if royalties for *rights* may not be payable under an agreement because a patent has expired or has been declared invalid, nevertheless, royalties for "nonpatent assets," such as engineering know-how, may remain payable and enforceable. See, e.g., *Chromalloy American Corp.* v. *Fischmann*, 716 F.2d 683 (9th Cir. 1983); *Span-Deck, Inc.* v. *Fab-Con, Inc.*, 677 F.2d 1237 (8th Cir. 1982), *cert. den.*, 103 S.Ct. 318 (1982); *St. Regis Paper Co.* v. *Royal Industries*, 552 F.2d 309 (9th Cir. 1977), *cert. den.*, 98 S.Ct. 633 (1977).

Petitioners respectfully suggest that *Brulotte* and *Mestre* are the beginning, not the end of this inquiry. In order to do justice among parties who have freely and fairly negotiated a trade secret licensing agreement which happens to outlive a subsequently issued patent, and in order to prevent a licensee from unjustly evading the royalty obligation it or its predecessor freely assumed, a searching inquiry must be made on the issue of leverage.

(Footnote 2 Continued)—

Remand of this case for trial will permit not only the reception of evidence on the "leverage" issue, but also on the issue of allocation of royalties between patent rights and nonpatent technical services and know-how. At the very least, the fact that the royalties in question were the sole compensation for the technical services and know-how to be rendered further diminishes the notion that the parties to the present agreement were influenced in their royalty negotiations by the possibility that a patent might later issue.

III. SECOND QUESTION PRESENTED FOR REVIEW

In reviewing the granting of summary judgment for the licensor, may the Court of Appeals make findings of fact concerning the parties' use of the leverage of a potential patent, and thereupon hold the agreement "*per se*" invalid beyond the expiration of such a patent?

As noted above, the District Court held that the application of a *per se* rule of invalidity was not appropriate where at the time of negotiation of the licensing agreement no patent had been issued or applied for.

> "We recognize that, regardless of whether an application has been made, one might improperly leverage the possibility that a patent might issue if the parties believe there is a substantial likelihood that a patent might issue. Under those circumstances, however, application of a *per se* rule is inappropriate. We hold, therefore, that the *per se* rule of *Brulotte* does not extend to the case where no patent application has been made at the time the agreement is negotiated even if an application is contemplated." 576 F. Supp. at 536-37.

Later in its opinion, after thoroughly considering the issue of conflict between trade secret licensing law and patent law in the light of this Court's decisions in *Kewanee* and *Aronson*, the District Court recognized that it still had to resolve the question of whether the Plaintiffs had used the leverage of a potential patent monopoly to extend the royalty payments beyond the lives of the patents. The District Court found that such leverage had not been used:

> "The answer to this question is located in the fact that the agreement at issue is one for the payment of royalties. Plaintiffs are not invoking the indeterminate protection of Ohio trade secret law. They are not seeking to prevent the public from manufacturing, selling, or using this invention. Rather, they seek to enforce the

> bargain they negotiated with defendant, i.e., the payment of royalties for a specified period in exchange for defendant's having the advantage of being first in the marketplace. We also note it was defendant—rather than plaintiffs—who primarily benefitted from the protection of the federal patent law. *We conclude, therefore, that plaintiffs did not use this agreement to extend their patent monopoly beyond the terms of the patents.* 576 F. Supp. at 539 (emphasis supplied).

The Court of Appeals disagreed with the District Court, and held that the *Brulotte* rule can be applied to invalidate *per se* a license agreement, such as the present one, where no patent was in existence or even applied for when the agreement was made:

> "We reverse this judgment and hold that the *Brulotte* rule of *per se* invalidity precludes enforcement of license provisions which were developed in anticipation of patent protection and which require royalty payments for use, sale or manufacture of a patented item beyond the life of the patent." 776 F.2d at 1319.

The Court of Appeals could not avoid, however, recognizing the fact that such a determination of "*per se*" invalidity depended upon the preliminary question of the use of patent leverage. Thus, in the first paragraph of its opinion, the Court of Appeals said:

> "We hold that under the rule of *per se* invalidity as established by *Brulotte* v. *Thys Co.* (citations omitted), the terms of a licensing agreement calling for royalty payments beyond the life of the patent are unenforceable *where the parties enter the agreement with clear expectations that a valid patent will issue.*" 776 F.2d at 1316 (emphasis supplied).

Indeed, the Court of Appeals cited and quoted this Court's statement of the leverage issue from *Aronson* as defining "the

nature of the leverage and the inquiry upon examination for abuse":

> "No doubt a pending patent application gives the applicant some additional bargaining power for purposes of negotiating a royalty agreement . . . However, the amount of leverage arising from a patent application depends on how likely the parties consider it to be that a valid patent will issue." 440 U.S. at 265, 99 S.Ct. at 1100, quoted at 776 F.2d, 1320.

Thus, both the District Court and the Court of Appeals recognized the preliminary issue that must be resolved before a *Brulotte* finding of invalidity can be made in the case of a licensing agreement negotiated before the issuance of a patent; and they each decided that issue differently. *That conflict alone demonstrates the existence of an issue of material fact.* The second issue which is presented to this Court, therefore, is whether the Court of Appeals properly decided the preliminary leverage question, or whether it should have remanded that question to the District Court for determination upon the reception of evidence on the question of whether "the parties enter(ed) the agreement with clear expectations that a valid patent (would) issue." 776 F.2d, at 1316. Curiously, the Court of Appeals reversed and remanded "for proceedings consistent with this opinion" *Id.*; and then went on to decide the issue of leverage, leaving the District Court nothing to do in such "proceedings."[3]

In this Court's formulation, as well as in that adopted by the Court of Appeals, the issue of leverage is a matter of the expectations, anticipations, and intentions of the parties to the licensing agreement at the time it was negotiated and

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[3] As noted above in the Statement of the Case, appeal was taken by Kenner only from the District Court's decision on the Eighth Affirmative Defense and Second Counterclaim, involving the claimed invalidity of the license agreement beyond the expiration date of the last patent. All remaining issues, primarily involving the method of calculating royalties, were resolved by a consent decree which was entered on June 12, 1984, and which was in the record before the Court of Appeals.

entered into. Such issues clearly are questions of fact. In *Pullman-Standard* v. *Swint*, 456 U.S. 273, 102 S.Ct. 1781, 72 L.Ed. 2d 66 (1982), this Court held that issues of intent are "factual matters for the triers of fact." 456 U.S. at 288, 72 L.Ed. 2d at 79. In the *Swint* case, the issue was whether a union seniority system had been adopted and maintained with discriminatory intent. After a lengthy trial, the District Court found that the seniority system was adopted and maintained wholly independent of any discriminatory intent. On appeal, the Court of Appeals for the Fifth Circuit reversed, reviewing the evidence and making its own finding of fact and invalidating the seniority system because it "resulted from an intent to discriminate because of race." (Quoted at 456 U.S. at 284, 72 L.Ed. 2d at 77.)

This Court reversed and remanded to the Court of Appeals for further proceedings, holding that the Court of Appeals had departed from the accepted and usual course of judicial proceedings by making findings of fact:

> "When an appellate court discerns that a district court has failed to make a finding because of an erroneous view of the law, the usual rule is that there should be a remand for further proceedings to permit the trial court to make the missing findings:
>
> > '[F]act finding is the basic responsibility of district courts, rather than appellate courts, and . . . the Court of Appeals should not have resolved in the first instance this factual dispute which had not been considered by the District Court.' " *DeMarco* v. *United States*, 415 U.S. 449, 450, n. 39 L.Ed. 2d 501, 94 S.Ct. 1185 (1974)

456 U.S. at 291-92, 72 L.Ed. 2d at 81-82.

The findings of the Court of Appeals were clearly and uniquely findings of fact. Thus, in concluding its opinion, the Court of Appeals found "that the parties assumed a high likelihood that valid patents would issue;" and "at the time the parties executed the license, the Plaintiffs exerted con-

siderable leverage from the anticipated patents." In its footnote 6, noting that Article VI of the agreement required royalty payments whether patents issued or not, the Court said "in light of the parties' clear contemplation of successful patent applications, the disclaimed relevance of the patent in Article VI must be discounted." 776 F.2d at 1321.

The *Swint* case, of course, involved the propriety of a court of appeals making findings of fact in reviewing the findings of a district court after trial, under the "clearly erroneous" standard of FED. R. CIV. P. 52(a). The impropriety of an appellate court making findings of fact in the first instance is equally, if not more, fundamental to appellate review of decisions on motions for summary judgment. A host of cases in the Circuit Courts have held that the role of an appellate court reviewing a summary judgment is to apply the same test as that utilized by the trial court to grant the motion, i.e., to determine whether there are issues of fact to be tried. If such issues of fact are discerned by the appellate court, it may not make findings of fact on those issues, but must remand to the trial court for findings of fact upon the reception of evidence. *McPhee* v. *Oliver Tyrone Corp.*, 489 F.2d 718 (5th Cir. 1974); *Radobenko* v. *Automated Equipment Corp.*, 520 F.2d 540 (9th Cir. 1975); *Glenway Industries, Inc.* v. *Wheelabrator-Frye, Inc.*, 686 F.2d 415 (6th Cir. 1982); *Ed Houser Enterprises, Inc.* v. *General Motors Corp.*, 595 F.2d 366 (7th Cir. 1979); *United States* v. *Gammache*, 713 F.2d 588 (10th Cir. 1983); *Molitor* v. *American President Lines, Ltd.*, 343 F.2d 217 (9th Cir. 1965).

Indeed, it has been held where, as the case was presented to the District Court, it was not apparent that any genuine issue of material fact was involved, but as the case unfolded in the Court of Appeals, genuine issues of material fact were revealed; under those circumstances, the Court of Appeals should reverse and send the case back for trial on those issues. *Smith* v. *U.S.*, 362 F.2d 366 (9th Cir. 1966).

The Court of Appeals attempted to resolve the issues of fact

regarding the intentions of the parties to this agreement by looking at the terms of the licensing agreement itself. The findings the Court of Appeals made, however, were severely flawed. None of them was clearly warranted by the language of the agreement itself, and all of them required the Court to indulge in assumptions concerning the intentions and expectations of the parties. Thus, for example, the Court of Appeals said that Article XIV, "Patent Infringement Search," required the licensors to obtain a patent infringement search "in order to determine the likelihood of receiving a patent." 776 F.2d at 1321. On the contrary, that was clearly not the case, because Article XIV in its very terms says that the patent infringement search was "in order to determine whether the within described extrusion device in its manufacturing, using or selling would constitute an infringement on a previously issued patent" (Appendix, p. 36a): in other words, whether the marketing of the device, patented or not, would infringe upon existing patents. Even accepting the Court of Appeals' construction of this provision, however, an infringement search to determine the likelihood of receiving a patent would clearly indicate that at the time of negotiating the agreement, the parties were decidedly uncertain about the patentability of the device.

In another instance, the Court of Appeals pointed to the provision of Article X that Kenner will admit the validity of any "patent under which rights herein are granted" as indicating "the parties' anticipation and expectation of successful patent applications." 776 F.2d at 1320. The opposite is true, however. This provision indicates, if anything, the uncertainty of the licensors that their invention was patentable. *Lear, Inc.* v. *Adkins*, 395 U.S. 653, 89 S.Ct. 1902, 23 L.Ed. 2d 610 (1969). Similarly, Article XIII(c), which gives the licensee the right to terminate the license in the event of unlicensed competition which the parties are "unable or unwilling to prevent or restrain," indicates that the licensee was uncertain, at the time of negotiation, that the extrusion device would be patentable. Yet, the Court of Appeals found

that this provision "suggests the entire license was premised upon the issuance of patents." 776 F.2d at 1321.

CONCLUSION

Once before, in its decision in *Kewanee Oil Co.* v. *Bicron Corp.*, 478 F.2d 1074 (6th Cir. 1973), *rev'd*, 416 U.S. 270 (1974), the Sixth Circuit Court of Appeals held that an Ohio trade-secret agreement could not be judicially enforced because its subject matter was preempted by the federal patent laws. This Court, of course, corrected the Sixth Circuit's view, and held that there was no federal preemption of the field of trade-secret licensing. Now, the Sixth Circuit has again mounted an attack on Ohio trade-secret law, holding in effect that wherever there is a patent, it must be held to obliterate any trade secret agreement covering the same subject matter, regardless of whether the parties to the agreement ascribed any decisive importance to patent protection. The Sixth Circuit's application of a *per se* rule of invalidity to the subject agreement, even though no patent existed at the time the agreement was made, was in conflict with this Court's analysis in *Brulotte* and *Aronson* that a conflict between state trade-secret law and federal patent law must first be shown by the leveraging of the potential patent monopoly before such an agreement may be held invalid. Finally, the Court of Appeals clearly departed from the accepted and usual course of judicial proceedings by making findings of fact upon review of a summary judgment involving the patent-leverage issue, rather than remanding the case for trial on that issue of fact.

While Petitioners would welcome full review of this case by the Court, in view of the Sixth Circuit's failure to remand for trial on the leverage issue, summary disposition of this cause under Rule 23 by a remand for trial on that issue will correct the error of the Court of Appeals and provide a proper factual

record to which this Court's *Brulotte*, *Kewanee*, and *Aronson* rules may be applied.

Respectfuly submitted,

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No. 84-3467

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ROBERT BOGGILD; WILLIAM L. DALE,
Plaintiffs-Appellees,
vs.
KENNER PRODUCTS, a Divison of CPG PRODUCTS CORP.,
Defendant-Appellant.

ON APPEAL from the United States District Court for the Southern District of Ohio.

Decided and Filed November 13, 1985

Before: KEITH and MARTIN, Circuit Judges; and DIGGS TAYLOR.*

KEITH, Circuit Judge: The issue in this case is whether the terms of a licensing agreement, which the parties entered into prior to application for or issuance of anticipated but subsequently issued patents, can be enforced beyond the expiration dates of the patents. We hold that under the rule of per se invalidity established by *Brulotte* v. *Thys Co.*, 379 U.S. 29 (1964), the terms of a licensing agreement calling for royalty payments beyond the life of the patent are unenforceable where the parties enter the agreement with clear expectations that a valid patent will issue. We therefore reverse the order of the district court granting partial summary judgment for the plaintiffs and remand for proceedings consistent with this opinion.

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* Honorable Anna Diggs Taylor, United States District Court for the Eastern District of Michigan, sitting by designation.

FACTS

Over twenty years ago, the plaintiffs-appellees, Robert Boggild and William Dale, invented a toy extruder to be used with the modeling substance called Play-Doh. In January 1963, the plaintiffs granted Kutol Products, Inc. an exclusive license to make, use and sell the extruder in conjunction with its line of Play-Doh products. Kutol subsequently assigned its rights and obligations under the 1963 license agreement to the defendant-appellant, Kenner Products.[1] At the time the plaintiffs executed the agreement, no patents on the extruder had been issued or applied for. However, under Article II of the agreement, upon execution of the license the plaintiffs were required to promptly apply for mechanical and design patents on the extruder.[2] The plaintiffs' patent applications were subsequently issued with expiration dates of March 2, 1979 for the design patent and August 9, 1983 for the mechanical patent.

Under the agreement, Kenner, the licensee, was required to pay royalty payments for a minimum of twenty-five years from the date of the license, or January 18, 1988, regardless of whether the anticipated patents issued or not.[3] Thus, the

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[1] As found by the district court, the agreement was subsequently modified by a 1966 agreement between plaintiffs and Rainbow Crafts, Inc., also a predecessor in interest to Kenner, and by a 1971 agreement between plaintiffs and defendant Kenner Products Division. The 1963 agreement, however, is the only agreement pertinent to this appeal.

[2] Article II of the 1963 agreement, entitled "Patent Applications," provides:

> "B & D will promptly file and diligently prosecute at their expense both mechanical and design patent applications directed to said Extrusion Device in the United States and Canada.
>
> * * *
>
> "It is agreed that if B & D fails to file the patent applications in the United States and foreign countries specified above Kutol shall have the right to file the said applications and to deduct the costs of such filing from royalty payments owed to B & D."

[3] Article VI(g) of the agreement provides for royalty payments regardless of compliance with Article II:

agreement required the royalty payments to continue four and a half years beyond the latest patent expiration date.

In March 1983, the plaintiffs filed in state court a breach of contract action challenging the method used by Kenner to calculate royalties due on the selling price of the extruder devices. Kenner petitioned for removal to the federal district court and filed an answer to the plaintiffs' complaint. In its answer, Kenner generally denied that it improperly calculated royalties, and asserted two counterclaims. The first counterclaim alleged that the plaintiffs owed Kenner an amount of royalty overpayments. The second counterclaim alleged that due to the expiration of the patents, Kenner was no longer obligated to pay royalties, and, despite the terms of the agreement, was entitled to make, use and sell the toy extruders without further payments.

Upon consideration of the plaintiffs' motion for partial summary judgment on Kenner's second counterclaim, the district court determined that since the patents had issued after the parties entered into the licensing agreement, the agreement did not run afoul of the holding in *Brulotte* v. *Thys Co.*, 379 U.S. 29 (1964), prohibiting a patent licensor from using the leverage of its patent to extend royalty payments beyond the patent's seventeen year term. *Boggild* v. *Kenner Products*, 576 F.Supp. 533, 536-37 (S.D. Ohio 1983). Kenner appeals the district court's grant of partial summary judgment for the plaintiffs on Kenner's second counterclaim.

> It is agreed by the parties hereto that the royalty payments provided for herein shall be paid by Kutol regardless of whether or not the filing of the patent applications contemplated in Article II hereof results in the issuance of a patent or patents.

And, Article XIII(d), entitled "Termination", provides for royalty payments for a minimum of twenty-five years:

> (d) Unless previously terminated in accordance with the foregoing provisions of this Article XIII, this agreement and the rights granted hereunder shall run to the full end of the term or terms of any Letters Patent that may issue on or as a result of the application or applications referred to in Article II hereof or for a period of 25 years, whichever is longer, and shall thereupon terminate.

DISCUSSION

The underlying policy of patent law grants a seventeen year monopoly to an inventor in exchange for release of the invention to the public upon expiration of the patent. *Scott Paper Co.* v. *Marcalus Manufacturing Co.*, 326 U.S. 249, 255 (1945); *see Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470, 480-81 (1974); *Lear, Inc.* v. *Adkins*, 395 U.S. 653, 673-74 (1969); *Brulotte* v. *Thys Co.*, 379 U.S. 29, 30-31 (1964); *Prestole Corp.* v. *Tinnerman Products, Inc.*, 271 F.2d 146, 155 (6th Cir. 1959), *cert. denied*, 361 U.S. 964 (1960). Thus, for a limited time, the inventor exclusively reaps any material rewards from the invention on condition that she disclose it to the public upon expiration of the patent. *Scott Paper Co.* v. *Marcalus Manufacturing Co.*, 326 U.S. at 255. The extensive social and economic consequences of the patent "give the public a paramount interest in seeing that patent monopolies are kept within their legitimate scope." *Precision Instrument Mfg. Co.* v. *Automotive Maintenance Machinery Co.*, 324 U.S. 806, 816 (1945). Hence, efforts to extend or reserve the patent monopoly beyond the seventeen years contravene the policy and purpose of the patent laws. *Scott Paper Co.*, 326 U.S. at 255-56; *Prestole Corp.* v. *Tinnerman Products, Inc.*, 271 F.2d at 155.

Accordingly, in *Brulotte* v. *Thys Co.*, 379 U.S. 29 (1964), the Supreme Court found that an owner of patents on hop-picking techniques who executed licensing agreements requiring royalty payments beyond the life of the patent had improperly used the leverage of his patents to extend the monopoly. The patent owner issued a license for the use of each hop-picking machine sold to farmers for a flat sum. Under the license, hop farmers paid the greater of either a minimum royalty of $500 per hop-picking season or $3.33-⅓% per two hundred pounds of hops harvested by the machine. The license also prohibited assignment and removal of the machines from the county where sold. All of the patents incorporated into the machines expired before the licenses. Nonetheless, the royalties and restrictions required

under the licenses remained in identical effect both before and after the last patent expired.

The hop farmers eventually refused to pay royalties accruing both before and after the expiration of the patents. The patent owner sued to enforce the licenses under state contract law and the farmers defended with misuse of the patents through projection of royalties beyond the expiration date of the patents. The trial court enforced the licenses, however the Supreme Court of Washington affirmed.

The United States Supreme Court reversed. The Court determined that the license provisions described above were intrinsically designed to protect the privileges of the patent monopoly and that their identical application to the post-expiration period constituted a "bald attempt to exact the same terms and conditions for the period after the patents have expired as they do for the monopoly period." *Brulotte* v. *Thys Co.*, 379 U.S. at 32. The Court found that, by their terms, the royalties were for use during the post-expiration period and did not constitute deferred payment for use during the pre-expiration period or a sale of unpatented machines through long term payments based on a deferred purchase price. *Id.* at 31-32. Since the license provisions failed to distinguish between the pre-expiration and post-expiration periods, the Court was unable to determine whether the post-expiration royalties were subject to the leverage of the patent. *Id.* The Supreme Court concluded that under these circumstances the patent owner had abused the leverage of the monopoly to project royalties into the post-expiration period; the agreement, therefore, was unlawful *per se*. *Id.*

In the case at bar, the district court reasoned that the *Brulotte* rule of *per se* invalidity was inapplicable because, unlike the hop-picking patents in *Brulotte*, the toy extruder patents had not been issued at the time the parties entered into the licensing agreement. *Boggild* v. *Kenner Products*, 576 F.Supp. at 536-37. Thus, the district court distinguished the present case as one involving patents which issued after the agreement and which conferred "hybrid" rights entailing

trade secrets as well as "potential patent rights in part." *Id.* The district court then rejected the Eleventh Circuit's holding in *Pitney Bowes, Inc.* v. *Mestre*, 701 F.2d 1365 (11th Cir.), *cert. denied*, 104 S.Ct. 239 (1983), which concluded that the *Brulotte* rule of *per se* invalidity could be applied to hybrid agreements executed while applications for patents were pending:

> In our view the Eleventh Circuit over extended the *Brulotte* rule. It is clear from that early case that the Supreme Court found that the agreement, on its face, revealed an improper leveraging of the patent monopoly. In *Brulotte*, the patents had issued; thus the patentee had something that he could leverage. Here, no application had been made. We recognize that, regardless of whether an application had been made, one might improperly leverage the possibility that a patent might issue if the parties believe there is a substantial likelihood that a patent might issue. Under those circumstances, however, application of a per se rule is inappropriate. We hold, therefore, that the per se rule of *Brulotte* does not extend to the case where no patent application has been made at the time the agreement is negotiated even if an application is contemplated.

576 F.Supp. at 536-37. We reverse this judgment and hold that the *Brulotte* rule of *per se* invalidity precludes enforcement of license provisions which were developed in anticipation of patent protection and which require royalty payments for use, sale or manufacture of a patented item beyond the life of the patent.

The Eleventh Circuit's decision in *Pitney Bowes, Inc.* v. *Mestre*, is significant for several reasons. In *Mestre*, a prospective patent owner executed four licenses for the sole and exclusive rights to make and sell four different paper handling machines. Three of the agreements licensed both patent rights and trade secrets, one licensed only trade secrets,[4] but all four

[4] The district court found that one agreement entitled the "Rotary Col-

agreements entitled Mestre to collect royalties on each machine. As in the case at bar, patents for the machines issued after execution of the agreements. However, unlike plaintiffs Boggild and Dale, Mestre had filed patent applications before the agreements were struck. Also, as in *Brulotte* and the case at bar, the royalty and use provisions did not distinguish between rates of payment for the pre-expiration and post-expiration periods or between royalties attributable to the patent rights and those for any other rights. Finally, like *Brulotte* and this case, the termination provisions in the *Mestre* agreements extended "hybrid" royalty payments beyond the life of the patent.

The United States District Court for the Southern District of Florida rejected Mestre's contention that the post-expiration royalties were attributable to the license for trade secrets and found that the hybrid agreement and Mestre's right to collect royalties thereunder ended upon expiration of the patent. *Pitney Bowes, Inc.* v. *Mestre*, 517 F.Supp. 52, 63 (S.D. Florida 1981). The Eleventh Circuit affirmed, ruling moreover that *Brulotte* was applicable to hybrid agreements and that issuance of the pending patent precluded enforcement of conflicting trade secret provisions. The circuit court found that under *Brulotte*, the agreement was invalid *per se* because the agreement's terms for royalty payments and exclusive use applied equally before and after expiration of the patent. 701 F.2d at 1373. Thus, the Eleventh Circuit found improper leveraging of the patent monopoly by applying *Brulotte's* rationale of *per se* invalidity to an agreement where the patents had not issued at the time of licensing but were

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lator Agreement" licensed trade secret rights only. 517 F.Supp. at 62. However, the Eleventh Circuit noted that during oral argument on appeal, Mestre conceded that like the other three, the Rotary Collator Agreement was a hybrid license for both patent rights and trade secrets. 701 F.2d at 1373 n.13. The Court of Appeals invited the district court to consider Mestre's concession and to apply *Brulotte* to the Rotary Collator Agreement as well. *Id.* Both the district court and Court of Appeals equated trade secrets with "know-how.". 517 F.Supp. 54 n.la; 701 F.2d at 1367 n.4.

pending and where trade secret rights were expressly included with patent rights.

We agree with the Eleventh Circuit that once the pending patent issues, enforcement of royalty provisions for other rights which conflict with and are indistinguishable from royalties for patent rights, is precluded. As noted in *Mestre*, the Supreme Court has upheld enforcement of potentially conflicting state trade secret provisions in hybrid agreements *only where no patents ever issued. See Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 257 (1979);[5] *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470 (1974). Upon issuance of the patent, however, federal supremacy requires directly conflicting provisions to be resolved under federal patent law. *Pitney Bowes, Inc.* v. *Mestre*, 701 F.2d at 1372.

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[5] In our view, *Aronson*, lends further support to the contention that the *Brulotte* rule of *per se* invalidity is applicable to hybrid agreements in which royalties for patent rights are indistinguishable from those for other rights. In *Aronson* the Supreme Court reversed an Eighth Circuit decision applying *Brulotte* to terms of an agreement which provided for a 5% royalty for exclusive rights to a keyholder design but reduced royalty payments if the inventor failed to obtain a patent within five years after the agreement. The patent applications failed and the reduced royalties became effective for an indefinite term. The Eighth Circuit concluded that had the pending patent issued, royalty payments could not have continued beyond the 17 year monopoly period. The Eighth Circuit reversed the district court judgment enforcing the terms of the agreement. *Quick Point Pencil Co.* v. *Aronson*, 567 F.2d 757 (8th Cir. 1977). The Supreme Court reversed and held that absent issuance of a patent, federal patent law does not preempt state contract law. The Court concluded the terms of the agreement contravened no purpose under the federal patent system and that the reduced royalty was not negotiated with the leverage of a patent. 440 U.S. at 265. In so holding, however, the Court specifically noted that had the patent issued, enforcement of the higher 5% royalty rate for exclusive rights beyond the life of the patent would have been precluded:

> "Mrs. Aronson attempted to obtain a patent for over five years. It is quite true that had she succeeded, she would have received a 5% royalty only on keyholders sold during the 17-year life of the patent."

440 U.S. at 263-64. Thus, the Court would presumably have applied *Brulotte* to a "hybrid" agreement embodying rights conferred under both state law and the federal patent law.

We also agree with the Eleventh Circuit that misuse of the leverage afforded by a pending patent is subject to the *Brulotte* rule of *per se* invalidity. In *Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 267 (1979) the Supreme Court acknowledged the leverage afforded to a patent owner by a pending patent application. Although the Court refrained from defining what constitutes abuse of such leverage, it described the nature of the leverage and the inquiry upon examination for abuse:

> No doubt a pending patent application gives the applicant some additional bargaining power for purposes of negotiating a royalty agreement. The pending application allows the inventor to hold out the hope of an exclusive right to exploit the idea, as well as the threat that the other party will be prevented from using the idea for 17 years. However, the amount of leverage arising from a patent application depends on how likely the parties consider it to be that a valid patent will issue.

440 U.S. at 265.

In *Mestre*, the agreement expressly referred to the pending patent applications, *see* 701 F.2d at 1370 n.9, and several of its provisions would become enforceable only if the patents issued. On these facts, the Eleventh Circuit concluded that the parties had anticipated issuance of the patents and that Mestre had obtained sufficient leverage from the pending patents to warrant application of the analysis in *Brulotte*.

In our view, the same violations of patent law arising from abuse of the leverage attached to a pending or issued patent can arise from abuse of the leverage afforded by an expressly anticipated application for a patent. The agreement at bar aptly demonstrates this contention. As noted in the facts section of this opinion, Article II of the licensing agreement required the plaintiffs "to promptly file and diligently prosecute mechanical and design patent applications" for the toy extruder. In fact the parties decreed in Article VI that no royalties would be paid until the plaintiffs applied for the mechanical patent.

Throughout the licensing agreement, similar provisions reiterate the parties' anticipation and expectation of successful patent applications. Article IV of the agreement grants the exclusive right to manufacture, use and sell the licensed extruder. Article X provides that the defendant Kenner will admit the validity of any "patent under which rights herein are granted." Article XII gives Kenner the sole right to proceed against infringers of "any patents granted on the applications or inventions herein licensed." And subparagraph (c) of Article XIII suggests the entire license was premised upon this issuance of patents: it gives Kenner the right to terminate the license in the event of unlicensed competition which the parties "are unable or unwilling to prevent or restrain." Paragraph XIV, entitled "Patent Infringement Search", required the plaintiffs to commission a patent infringement search by a reputable patent law firm within thirty days after execution of the agreement in order to determine the likelihood of receiving a patent. Moreover, as noted above in footnote 3 of this opinion, the termination provisions of Article XIII(d) not only contemplate the anticipated patents but expressly require all terms of the agreement to run a minimum of twenty-five years, four and a half years beyond the life of the subsequently issued mechanical patent.

Thus, the tenor of the licensing agreement compels us to find that the possibility of forthcoming patents on the toy extruder substantially contributed to the formation of the licensing agreement and that the parties assumed a high likelihood that valid patents would issue. The terms of the licensing agreement compel the conclusion that, at the time the parties executed the license, the plaintiffs exerted considerable leverage from the anticipated patents. In our view, the absence of a filed patent application is, under these circumstances, irrelevant to the analysis under *Brulotte*.

Having established the leverage from anticipated patents, our inquiry next focuses on whether such leverage was misused to project the monopoly beyond the life of the patent. In *Brulotte* the Supreme Court found a *per se* projection of the monopoly where the provisions protecting the exclusive rights

conferred by the patent applied without change to the post expiration period and where royalties for use during the patent were indistinguishable from royalties due after expiration. *Brulotte* v. *Thys Co.*, 379 U.S. at 32. In the case at bar, the agreement calls for royalties on the sales of the patented extruder for a minimum of twenty-five years.[6] As in *Brulotte*, the agreement contains neither provisions for reduction of royalties in the event valid patents never issued nor terms for reduction of post-expiration royalties. The provisions for use of the extruder and payment of royalties are applicable to both the pre-expiration and post-expiration periods. Therefore, under *Brulotte*, the agreement is unlawful *per se*.

Accordingly, the district court's grant of partial summary judgment to the plaintiffs is hereby reversed.

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[6] Although Article VI of the agreement requires royalty payments whether the patents issued or not, the only royalties required are those on sales of the patent device. In light of the parties' clear contemplation of successful patent applications, the disclaimed relevance of the patent in Article VI must be discounted.

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

C-1-83-638

ROBERT BOGGILD,
and
WILLIAM L. DALE,
Plaintiffs,

vs.

KENNER PRODUCTS, Division of
GENERAL MILLS FUND GROUP, INC.,
Defendant.

OPINION AND ORDER GRANTING PLAINTIFF'S MOTION FOR PARTIAL JUDGMENT ON THE PLEADINGS AND DENYING DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

[Filed December 15, 1983]

SPIEGEL, J.:

This matter came on for hearing on the plaintiffs' motion for partial judgment on the pleadings with respect to defendant's eighth affirmative offense and second counterclaim (doc. 8) and defendant's cross-motion for partial summary judgment on its second counterclaim, or in the alternative to suspend both motions so that discovery with respect to these motions can be conducted (doc. 9). Defendant filed a memorandum in opposition to plaintiffs' motion and in support of its own motion (doc. 10) and a reply memorandum (doc. 15). Plaintiffs filed a reply memorandum in support of their motion and opposing defendant's motion (doc. 14).

Defendant's alternative motion to suspend both motions is denied as we find that additional discovery is not necessary to

decide the issues presented to us by the cross-motions. We find that there are no genuine issues of material fact with respect to defendant's second counterclaim and eighth affirmative defense and further that plaintiff is entitled to judgment as a matter of law on that counterclaim and defense. Accordingly, defendant's motion is denied. Plaintiffs' motion is granted.

Underlying this action is a toy extruder device invented by plaintiffs. That device is the subject of an agreement and its amendments under which plaintiffs granted exclusive rights to the invention to Kutol Products, Inc. (*see* complaint, exh. A). Kutol, Kenner's predecessor in interest, subsequently assigned its rights and obligations under the agreement to defendant Kenner.

The parties entered into the licensing agreement January 18, 1963.[1] Plaintiff subsequently applied for mechanical and design patents on their invention as required by Article II of the agreement. Both patents issued. The design patent expired March 2, 1979; the mechanical patent, August 9, 1983.

Plaintiffs brought this action challenging the way in which defendant has calculated royalties and alleging unauthorized use without payment of royalties. They seek an accounting and damages.

Defendant filed an answer in which it asserted two counterclaims, the second of which is the subject of these motions. That counterclaim seeks a declaration that as of August 9, 1983, when the second patent expired, defendant owed no further obligation to pay royalties to plaintiffs under the licensing agreement and may manufacture, use and sell the device disclosed or claimed in the two patents disclosing the extruder device without obligation to plaintiffs. This counterclaim is the obverse of defendant's eighth affirmative

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[1] This agreement was subsequently modified by a 1966 agreement between plaintiffs and Rainbow Crafts, Inc., also a predecessor in interest of the present defendant, and by a 1971 agreement between plaintiffs and defendant, Kenner Products Division. The 1963 agreement, however, is the only agreement pertinent to these cross-motions.

defense, which asserts that the expiration of the patents covering the device bars plaintiffs from enforcing the licensing agreement.

Article IV of the agreement gives defendant the exclusive right to manufacture, use and sell the licensed extruder device. Article II requires that plaintiffs file patent applications covering the device. Article VI(g), however, states:

> It is agreed by the parties hereto that the royalty payments provided for herein shall be paid by Kutol regardless of whether or not the filing of the patent applications contemplated in Article II hereof results in the issuance of a patent or patents.

Article XIII(d) of the agreement provides:

> Unless previously terminated in accordance with the foregoing provisions of this Article XIII, this Agreement and the rights granted hereunder shall run to the full end of the term or terms of any Letters Patent that may issue on or as a result of the application or applications referred to Article II hereof or for a period of 25 years, whichever is longer, and shall thereupon terminate.

As noted, the last of the applicable patents expired August 9, 1983. The twenty-five year period from the date of the license agreement will not expire until January 18, 1988.

The unambiguous language of the agreement makes it clear that the parties intended that royalty payments would continue whether or not the patents issued. Further, the payments would continue for a minimum of twenty-five years.

It is also undisputed that the inventors had not yet applied for patents covering the extruder device at the time the agreement was entered into. The agreement thus involved the disclosure and licensing by Boggild and Dale to Kutol of certain confidential information in the form of finished drawings of the design and a working model of the extrusion device.

Defendant's eighth affirmative defense and second counterclaim are grounded upon the proposition that the licensing

agreement loses its validity and enforceability upon the expiration of the patents covering the licensed device. In effect, defendant argues that once the patents issued, plaintiffs lost the protection of state trade secret and/or contract law in exchange for the patent protection conferred by federal law. Defendant frames the issue raised by the cross-motions thusly:

> [W]hether a license agreement that expressly provides for the payment of royalties on the sales of defined subject matter for a term extending beyond the life of a patent which was contemplated by the contract to cover the defined subject matter and which in fact does cover it is enforceable for the full term expressed by the agreement regardless of the expiration date of the patent, or whether the agreement becomes unenforceable as a matter of law upon the expiration of the patents.

(doc. 10 at 1-2). Defendant relies on *Brulotte* v. *Thys Co.*, 379 U.S. 29, 32 (1964) in which the United States Supreme Court held that regardless of state contract law, a licensing agreement that extends a patent's monopoly beyond the life of the patent involved is a per se violation of federal patent law. Defendant concludes that the licensing agreement became violative of federal law and thus unenforceable as of August 9, 1983 when the latter patent expired.

It is fundamental that any attempt to continue "the patent monopoly, after the patent expires, whatever the legal device employed, runs counter to the policy and purpose of the patent laws." *Scott Paper Co.* v. *Marcalus Co.*, 326 U.S. 249, 256 (1945) quoted in *Brulotte*, 379 U.S. at 31. In *Brulotte* the Supreme Court held that royalty provisions of a licensing agreement covering the use of machines incorporating certain patents are not enforceable beyond the expiration of the last patent incorporated in the machine. The court observed that a patentee may use his patent to exact the highest royalties possible, using his monopoly as leverage. 379 U.S. at 33. However, it held unlawful per se a patentee's use of a royalty agreement extending beyond the date of the patent. 379 U.S. at 32.

As plaintiffs point out, the facts of *Brulotte* are distinguishable. The royalty agreements in *Brulotte* issued in connection with the sale of machines incorporating seven patents, all of which had isued prior to the execution of the agreements, and licensed the use of the patent ideas. Thus the rights licensed were exclusively patent rights. In the present case, however, the agreement preceded the patents and thus the rights licensed are more properly characterized as trade secret rights — at least in part — and potential patent rights in part.

Defendant's response is that *Brulotte's* per se rule extends to agreements where a patent is applied for and issues after the agreement is negotiated. Defendant refers to *Pitney Bowes, Inc.* v. *Mestre*, 701 F.2d 1365 (11th Cir. 1983), *cert. denied*, 52 U.S.L.W. 3291 (Oct. 11, 1983).

At issue in *Mestre* was a hybrid agreement licensing both patent rights and trade secret rights and providing for royalties in exchange for the sale and exclusive right to manufacture and sell a machine described in then pending patent applications. The agreement expired on the latest of three dates — the patentee's death, after seventeen years, or when the last patent on the machine expired. The last patent expired approximately eighteen months prior to the patentee's death. The Eleventh Circuit held that the agreement was unenforceable under *Brulotte* on the grounds that two provisions suggested that the patentee used the leverage of his patent to extend the monopoly beyond the seventeen year patent period. First, the exclusive rights licensed under the agreement applied equally before and after expiration of the patent and second, the agreement required the licensee to pay royalties at the same rate and on the same basis both before and after expiration of the patent. 701 F.2d at 1373.

In our view the Eleventh Circuit over extended the *Brulotte* rule. It is clear fr m that early case that the Supreme Court found that the agreement, on its face, revealed an improper leveraging of the patent monopoly. In *Brulotte*, the patents had issued; thus the patentee had something that he could leverage. Here, no application had been made. We recognize that, regardless of whether an application has been

made, one might improperly leverage the possibility that a patent might issue if the parties believe there is a substantial likelihood that a patent might issue. Under those circumstances, however, application of a per se rule is inappropriate. We hold, therefore, that the per se rule of *Brulotte* does not extend to the case where no patent application has been made at the time the agreement is negotiated even if an application is contemplated.

That, however, is not the end of our inquiry, for in this case patents did issue. We must, therefore, consider the proper relationship between federal patent law and state law in such a situation.

The test we must apply is whether state law which would otherwise render this agreement enforceable "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941), quoted in *Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 257, 262 (1979). If state law does not present such an obstacle, then state law governs. Conversely, if state law otherwise rendering this agreement enforceable conflicts with federal law, then federal law governs.

As a preliminary matter, we note the clear distinction between the protection afforded by federal patent law and that available under state trade secret law. Under federal patent law, the inventor of a patentable "useful process, machine, manufacture, or composition of matter, or . . . useful improvement thereof," 35 U.S.C. § 101, is granted an exclusive monopoly to sell or use his invention for seventeen years, at the end of which the invention will be disclosed to the public. 35 U.S.C. § 154; *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470, 480-81 (1974). Trade secrets, on the other hand, may or may not be patentable. The holder of a trade secret is protected against the disclosure or unauthorized use of the trade secret by those to whom it has been confided on condition that the secret not be disclosed. The holder is also protected against use of the trade secret where knowledge of the trade secret has been acquired by some improper means. O.R.C. § 1333.51; Restatement of Torts § 757(a). However, although

the protection accorded a trade secret holder is for an indefinite period of time, the holder — unlike the patentee — runs the risk that his secret may be discovered through proper means such as independent invention or reverse engineering. In that event, the trade secret holder cannot prevent disclosure or use of his secret, unlike the patentee who can do so if his patent is not yet expired.

The Supreme Court has held that state trade secret law is not preempted by federal patent law. *Kewanee Oil Co.* v. *Bicron Corp.*, 416 U.S. 470 (1974). With respect to clearly patentable inventions, the Court found that extending trade secret protection to such inventions does not conflict with the patent policy of disclosure. *Id.* at 489-93.

Kewanee, however, was an action seeking relief from the misappropriation of trade secrets and was based upon employment agreements requiring the non-disclosure of confidential information or trade secrets obtained as employees. The case thus did not present the issue of how royalty payments should be treated where licensed ideas were accorded the protection of federal patent law after the parties entered into a licensing agreement.

The Supreme Court subsequently held that state contract law is not preempted by federal patent law in an action to enforce a contract to pay royalties to a patent applicant on sales of goods involving the putative invention where the patent was not granted. *Aronson* v. *Quick Point Pencil Co.*, 440 U.S. 257 (1979). While Mrs. Aronson's patent application was pending, Quick Point entered into a contract with her pursuant to which it would pay her five percent of the selling price in exchange for the exclusive right to make and sell the keyholder covered by her pending application. The contract further provided that if the patent did not issue within five years, Quick Point would pay a royalty of two and one-half percent of sales so long as Quick Point continued to sell the keyholder. No patent issued.

Quick Point subsequently brought an action to have the contract declared unenforceable on the ground that state contract law — which might otherwise make the contract en-

forceable — was preempted by federal law. The Supreme Court noted that at the time the contract was executed, the parties knew about the pending patent application and recognized the possibility that a patent might not issue. The Court observed that despite the uncertainty of patent protection, Quick Point obviously placed a significant value on being the first to exploit the basic novelty of the keyholder. *Id.* at 261-62.

On these facts, the Supreme Court found no conflict with any of the three goals of patent law: incentive to invention, disclosure, and the policy against withdrawing ideas from the public domain. The Court found that state contract law provided an additional incentive to invention and that encouraging inventors to arrange for the manufacture of their inventions furthered the federal policy of disclosing inventions. Finally, it found that enforcing a contractual obligation to pay royalties does not conflict with federal policy against withdrawing ideas from the public domain because enforcement would not withdraw the idea from the public domain. The Court reasoned that Mrs. Aronson's idea entered the public domain as a result of the agreement licensing the manufacture and sale of her invention. *Id.* at 262-63. The Court maintained that its reasoning was consistent with that of *Brulotte* because on this record it was clear that although the pending application may have served Mrs. Aronson as leverage, that leverage was not abused as the reduced royalty provision revealed that both parties recognized a substantial likelihood that the patent would not issue. *Id.* at 264-65.

Defendant insists that *Aronson* is not applicable as no patent issued in that case and thus there could be no conflict between federal and state law. Further defendant maintains that the language of *Aronson* makes it clear that *Aronson* does not apply where a patent does issue. Defendant points out that its interpretation of the *Aronson* decision is consistent with the Eleventh Circuit's analysis of *Aronson* in *Pitney Bowes, Inc. v. Mestre*, 701 F.2d 1365 (11th Cir. 1983), *cert. denied*, 52 U.S.L.W. 3291 (Oct. 11, 1983). Finally, it insists that a proper reading of Supreme Court cases leads inevitably

to the conclusion that the Eleventh Circuit's reasoning in *Mestre* must be applied to the instant case.

As discussed earlier, *Mestre*, like *Aronson* and the instant case, involved a hybrid agreement. The Eleventh Circuit stated that in its view, and despite *Kewanee* and *Aronson*, the Supreme Court did not "necessarily" intend full trade secret protection where a patent issues subsequent to an agreement to pay royalties. It then stated:

> *When a patent issues, the potential exists for direct conflict between federal patent law and state trade secret law.* When such a conflict occurs, the question is no longer one of federal preemption; it is instead one of federal supremacy.

Id. at 1372 (footnote omitted) (emphasis added). In other words, under the *Mestre* analysis, where a patent has issued, the Court must determine not whether federal law preempts but rather whether there is a conflict between federal and state law.

Because patents issued in this case, the question is not one of preemption, but rather of supremacy, as the Eleventh Circuit stated. However, in resolving a supremacy issue as in resolving a preemption issue, the fundamental question is whether there is a conflict. The Supreme Court's preemption discussions are thus critical to our own analysis.

The one principle that clearly emerges is that we must examine the agreement in light of the purposes of the federal patent law. Those purposes are well established: to foster and reward invention; to foster disclosure of inventions in order to stimulate further innovation and to permit the public to practice the invention following expiration of the patents; and to assure that ideas in the public domain remain there for the free use of the public. *Aronson*, 440 U.S. at 262, citing *Kewanee*, 416 U.S. at 480-81. We conclude that enforcing this agreement will not conflict with any one of these purposes.

First, the Supreme Court has already stated that permitting inventors to make enforceable licensing agreements in ex-

change for royalties provides an additional incentive to invention and thus is consistent with federal policy. *Aronson*, 440 U.S. at 262. We find that this incentive exists whether or not a patent issues. Secondly, the Supreme Court has stated that encouraging inventors to arrange for the manufacture of their inventions furthers the policy of disclosure because each manufactured item discloses the invention. *Aronson*, 440 U.S. at 262-63. The situation is similar here; the effect of the agreement was to disclose the extruder device to the public. The agreement does not give the plaintiffs protection beyond that available to them under the patent law. As of the expiration of the last patent, any member of the public may manufacture, use, or sell the device. All the agreement requires is that the defendant continue to pay for the privilege of having been first in the market place. And third, enforcing a contract for royalties does not conflict with the policy against withdrawing ideas from the public domain. *Aronson*, 440 U.S. at 263. That policy is executed by issuing patents only to inventions that meet the exacting standards enacted by Congress. The agreement required the plaintiffs to seek the added protection of the patent law on behalf of the defendant. The effect of the patent was to withdraw the idea from the public domain for seventeen years. Now that the patents have expired the idea is in the public domain. All this agreement requires is that the defendant continue to pay royalties — as it agreed to do — for a period of time in exchange for the advantage of having been the first manufacturer of the device.

Even though there is no conflict with federal patent law, we are nonetheless left with the question posed by *Scott Paper* and *Brulotte:* whether the plaintiffs used the leverage of a patent to extract rights that would not otherwise be available to them and that went beyond the rights available to them under the federal patent law. *Scott Paper* prohibits the use of any legal device to extend the patent monopoly beyond the expiration of the patent. 326 U.S. at 256. *Brulotte* forbids the use of a patent monopoly as leverage to project the patent monopoly beyond the term of the patent. 379 U.S. at 32.

The answer to this question is located in the fact that the

agreement at issue is one for the payment of royalties. Plaintiffs are not invoking the indeterminate protection of Ohio trade secret law. They are not seeking to prevent the public from manufacturing, selling or using this invention. Rather they seek to enforce the bargain they negotiated with defendant, *i.e.*, the payment of royalties for a specified period in exchange for defendant's having the advantage of being first in the market place. We also note that it was defendant — rather than plaintiffs — who primarily benefitted from the protection of the federal patent law. We conclude, therefore, that plaintiffs did not use this agreement to extend their patent monopoly beyond the terms of the patents. Moreover, we conclude that even if plaintiffs did use the possibility that their invention might be patentable as leverage, that leverage was not used to project the patent monopoly but rather to extract higher royalties. Accordingly, we find that this agreement does not fall within the prohibitions of *Scott Paper* and *Brulotte*.

We recognize that in *Aronson*, the Supreme Court concluded that Mrs. Aronson had not improperly leveraged her pending application because the agreement provided for lower royalties if the patent did not issue. 440 U.S. at 264-65. The parties in our case did not include such a provision which could make such a conclusion inevitable. That language, however, is dicta. More important, nothing in *Aronson* suggest that an inventor may not use the possibility that his idea is patentable as leverage. What is prohibited is using that leverage to extend a patent monopoly. We read *Scott Paper*, *Brulotte*, and *Aronson*, as permitting an inventor to leverage the possibility that his invention is patentable for the purpose of extracting more advantageous royalty terms for a specified and reasonable period of time even if subsequent to the agreement a patent does issue but the patent expires before the negotiated period over which royalties are payable.

In the instant case, it is unnecessary to determine whether plaintiffs used the possibility that their invention was patentable as leverage. It is clear from the undisputed facts that even if that possibility was leveraged it was for the purpose of

extracting higher royalties, not of unlawfully extending the patent monopoly.

To summarize, what the defendant negotiated for in this case was for the right to be first in the marketplace with a novel idea. The parties drafted an agreement which made it clear that the defendant was willing to pay for that right whether or not the patent issued. In the event the patent issued the defendant would have additional protections. We simply see no way in which this conflicts with any of the three stated and clearly recognized purposes of the federal patent law. We find that state law does not stand as "an obstacle to the accomplishment and execution of the sole purposes and objectives" of federal patent law. *Hines*, 312 U.S. at 67.

We find further that the language of the agreement reveals that this agreement is not an attempt to extend a patent monopoly beyond the term of the patent. Moreover, we find that because plaintiffs did not seek to extend the patent monopoly beyond its term, whether they leveraged the possibility that their invention was patentable is not material. Accordingly, we conclude that this agreement for the payment of royalties is enforceable under state law.

As there are no disputed issues of material fact, we hold that plaintiffs are entitled to judgment as a matter of law on defendant's second counterclaim and defendant's eighth affirmative defense. Accordingly, judgment is hereby entered against defendant and for plaintiffs on defendant's second counterclaim.

SO ORDERED.

/s/ S. ARTHUR SPIEGEL
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 84-3467

ROBERT BOGGILD, WILLIAM L. DALE,
Plaintiffs-Appellees,

v.

KENNER PRODUCTS, Division of CPG Products Corp.,
Defendant-Appellant.

Before: KEITH and MARTIN, Circuit Judges; and
TAYLOR, District Judge.

JUDGMENT

[Filed November 13, 1985]

ON APPEAL from the United States District Court for the Southern District of Ohio.

THIS CAUSE came on to be heard on the record from the said District Court and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this court that the judgment of the said District Court in this case be and the same is hereby reversed and the case is remanded for proceedings consistent with this opinion.

It is further ordered that Defendant-Appellant recover from Plaintiffs-Appellees the costs on appeal, as itemized below, and that execution therefor issue out of said District Court, if necessary.

ENTERED BY ORDER OF THE
COURT

John P. Hehman, Clerk

/s/ JOHN P. HEHMAN,
Clerk

Issued as Mandate: January 9, 1986
COSTS: Awarded to appellant

Filing fee	$ 70.00
Printing	$506.40
Total	$576.40

A True Copy.
Attest:
/s/
Deputy Clerk

No. 84-3467

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ROBERT BOGGILD, WILLIAM L. DALE,
Plaintiffs-Appellees,

v.

KENNER PRODUCTS, A DIVISION OF
CPG PRODUCTS CORP.,
Defendant-Appellant.

ORDER

[Filed January 2, 1986]

Before: KEITH and MARTIN, Circuit Judges; and DIGGS TAYLOR*, United States District Judge

The Court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this Court, and no judge of this Court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

ENTERED BY ORDER OF THE
COURT

/s/ JOHN P. HEHMAN, Clerk

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* Hon. Anna Diggs Taylor sitting by designation from the Eastern District of Michigan.

1963 LICENSE AGREEMENT

AGREEMENT

This Agreement dated as the 18th day of January, 1963 and effective as of that date, by and between Robert Boggild and William L. Dale, individuals, both residing in the City of Cincinnati, Ohio (hereinafter referred to as B & D) and Kutol Products, Inc., a corporation of Ohio having its principal place of business at Cincinnati, Ohio (hereinafter referred to as Kutol), witnesseth:

WHEREAS, B & D *developed certain information* relating to an Extrusion Device and have disclosed such information to Kutol by means of finished drawings copies of which are attached as Exhibit A and a working model; and

WHEREAS, Kutol is desirous of utilizing *said information* and to manufacture and sell said Extrusion Devices, and B & D is willing to grant such rights for the purposes and on the conditions hereinafter set forth:

NOW, THEREFORE, in consideration of the premises and the mutual covenants of this agreement, the parties hereto agree as follows:

I. SCOPE OF AGREEMENT

The field and scope of this agreement and the rights and obligations set forth herein shall be limited to a toy Extrusion Device of the general type and substantially in accordance with the prior disclosure to Kutol by B & D and includes an extruder for manually forcing modeling compound through dies of varying shapes.

II. PATENT APPLICATIONS

B & D will promptly file and diligently prosecute at their expense both mechanical and design patent applications directed to said Extrusion Device in the United States and Canada.

B & D shall file patent applications directed to said Extrusion Devices in the United Kingdom, France, Germany and Italy.

To prevent inadvertent bars to valid patent protection prior to the filing of the United States mechanical patent application Kutol agrees to give B & D 15 days advance notice that said Extrusion Devices will be put on sale or in public use or will be described in a printed publication.

It is agreed that if B & D fails to file the patent applications in the United States and foreign countries specified above Kutol shall have the right to file the said applications and to deduct the costs of such filing from royalty payments owed to B & D.

III. TRADEMARKS

Any and all trademarks and tradenames used in connection with the sale of the devices which are the subject matter of this agreement, together with the good will of the business founded thereon shall be the property of Kutol.

IV. RIGHTS GRANTED

(a) B & D hereby grants to Kutol and Kutol hereby accepts, subject to the covenants and conditions hereinafter expressed, the exclusive right, license and privilege of manufacturing and of using and selling throughout the world and including the exclusive right to sue for infringement, the aforesaid Extrusion Devices constructed in accordance with inventions and improvements hereinafter identified during the term of this agreement which shall remain *exclusive with Kutol subject to the conditions hereinafter expressed.*

(b) B & D hereby grants to Kutol the exclusive worldwide rights to any improvements upon the subject matter of this agreement that may be made by B & D during the life of this agreement, which shall come under the terms of this agreement and shall be available to Kutol without any additional royalty payments over and above that hereinafter specified.

(c) B & D hereby grants to Kutol any improvements

made by others on Extrusion Devices which are the subject matter of this agreement, which B & D may acquire, or come under its control, during the life of this agreement, which improvements shall be the property of, and properly assigned to Kutol to the full extent of B & D's interest therein.

(d) B & D hereby grants to Kutol and Kutol hereby accepts, subject to the covenants and conditions herein expressed, the right to grant to other manufacturers throughout the world, sublicenses to manufacture, use and sell the Extrusion Devices.

V. TECHNICAL ASSISTANCE

B & D will provide engineering drawings suitable for use in purchasing of required parts and design of tooling and will further provide working models of said Extrusion Device having a pleasing appearance of a quality sufficient to demonstrate the product to potential customers. B & D will participate in negotiations to obtain suppliers for parts and will work with parts manufacturers and/or assemblers until the product is established in satisfactory repetitive manufacture and will redesign the devices as required to eliminate any design or mechanical faults that appear after manufacture is started. B & D will further establish standards for manufacture of the device and agree to communicate to Kutol any technical knowhow, data or other information pertinent to the subject devices which are now in B & D's possession or which may hereinafter within the term of this agreement be acquired by B & D.

B & D will provide similar technical assistance to sublicensees of Kutol, reasonable charges for services and expenses to be borne by licensees.

VI. REPORTS AND ROYALTIES

(a) During the term of this agreement, Kutol shall make written reports to B & D within fifteen (15) days after the last day of the preceding month, stating in such reports the number of Extrusion Devices sold or otherwise disposed of during

the month for which a report is rendered. The first such report shall include all Extrusion Devices sold or otherwise disposed of between the date of this agreement and the terminal date of such report.

(b) Kutol also agrees to continue making monthly reports to B & D after the date of any termination of this agreement, stating in such report, the number of Extrusion Devices sold or otherwise disposed of hereunder and not previously reported to B & D until the complete inventory of devices has been sold or otherwise disposed of.

(c) The expression "sold or otherwise disposed of" shall include in its meaning (1) those devices not sold but delivered by Kutol to others regardless of the basis for compensation if any; and (2) devices put into use by Kutol for any purpose other than routine testing of such devices.

(d) Under this agreement, Extrusion Devices shall be considered to be sold when billed out. Royalties paid on any devices which are not accepted by Kutol customers for any reason, however, shall be credited to Kutol.

(e) In order to insure to B & D the full royalty payments contemplated hereunder, Kutol covenants that, in the event that any Extrusion Devices licensed hereunder shall be sold for resale either (1) to a corporation, firm or association which, or individual who, shall own a controlling interest in Kutol by stock ownership or otherwise, or (2) to a corporation, firm, or association in which Kutol or its stockholders shall own a controlling interest by stock ownership or otherwise, the royalties to be paid hereunder in respect to such devices shall be based upon the selling price at which such purchaser resells such devices, rather than upon the net selling price of Kutol.

(f) Concurrently with the making of any report under this agreement, Kutol shall pay to B & D royalties in accordance with the following schedule:

(1) Three (3%) per cent of the "on the dock" selling price for the first 100,000 Extrusion Devices; four (4%) per cent of the "on the dock" selling price for

all Extrusion Devices between 100,000 and 500,000; and five (5%) per cent of the "on the dock" selling price for all Extrusion Devices sold in excess of 500,000 by Kutol and its United States licensees and assigns.

(2) Accessories designed by B & D and licensed hereunder to Kutol for use with the extruder and sold separately shall be subject to the same royalty schedule as Item (1) above.

"On the dock" selling price is defined as Kutol's or its licensee's invoice price of the final packaged product as sold to a buyer not controlled by Kutol or its licensees as defined in Article VI (e).

(g) It is agreed by the parties hereto that the royalty payments provided for herein shall be paid by Kutol regardless of whether or not the filing of the patent applications contemplated in Article II hereof results in the issuance of a patent or patents.

(h) In event royalties accrued and paid hereunder do not aggregate a minimum of One Thousand Dollars ($1,000.00) which shall be due and payable by Kutol to B & D on or before December 31, 1963, and annually thereafter, Kutol shall make up the deficiency of the actual royalties paid to such minimum sum.

(i) It is agreed that no royalties shall be paid to B & D until a mechanical patent application is filed in the United States, but that upon the notification of such filing all royalties which have accrued from past sales shall be paid with the next succeeding monthly report.

(j) Kutol shall require every party sub-licensed by Kutol in the United States or foreign countries to guarantee that the annual royalty paid to B & D under the sub-license shall not be less than $500.00. Each sub-license shall contain a royalty schedule as set forth in VI (f) herein.

VII. RECORDS

Kutol agrees to keep records showing the sales of Extrusion Devices sold or otherwise disposed of under the license herein granted in sufficient detail to enable the royalties payable hereunder by Kutol to be determined, and further agrees to permit its books and records to be examined during ordinary business hours from time to time for the purpose only and only to the extent necessary to verify the reports provided for in paragraphs (a) and (b) of Article VI, such examination to be made at the expense of B & D by an independent auditor appointed by B & D who shall report only the amount of royalty due and payable.

VII. NO IMPLIED RIGHTS

Without limiting the grants provided in Article IV above, no rights are granted or implied by this agreement under any patents other than those which shall be issued on or as a result of the application or applications referred to in Article II of this agreement.

IX. NOMENCLATURE

Kutol agrees to inform B & D promptly after the execution of this agreement as to the specific nomenclature and type designation under which Kutol will render bills covering sales of Extrusion Devices under the rights herein granted, and further agrees to inform B & D of any change or new designations which may thereafter be made or adapted to such presses, and Kutol in rendering bills for Extrusion Devices sold under the rights herein granted, agrees that it will in such bills invariably use the nomenclature and type designation so furnished to B & D.

X. ADMISSION OF VALIDITY

If a patent or patents are issued pursuant to Article II above, Kutol will admit the validity of said letters patent under which rights herein are granted thereto, and will agree

that it will not during the term of this agreement directly or indirectly attack or question the same, but such admission of validity is limited to the scope of the rights granted and to the term of this agreement.

XI. ASSIGNABILITY

(a) The obligations of Kutol hereunder, including the obligations to make reports and pay royalties, shall run in favor of the successors, assigns, or other legal representatives of B & D.

(b) Kutol's rights under this agreement and the license herein granted shall pass to any assigns for the benefit of creditors of Kutol and to any receiver of its assets, or to any person or corporation succeeding to its business in the Extruder Device as a result of sale, consolidation, reorganization, or otherwise, and Kutol shall have the right to grant sublicenses, provided that such assignee, receiver, sublicensee, person or corporation shall accept in writing the provisions of this agreement and agree to become in all respects bound thereby, but may not be otherwise transferred without the written consent of B & D. The failure of an assignee to so accept the terms of this agreement shall result in the termination of this agreement and the failure of a sub-licensee to so accept the terms of this agreement shall result in the termination of the sub-license.

Termination under this paragraph can be effected only as follows: if within 60 days following the transfer of rights as provided above B & D has not received an acceptance of the terms of this agreement, B & D shall give Kutol or its assignee notice by registered mail of the failure to accept. This agreement or the sub-license, whichever is applicable, shall be automatically terminated if the terms of this agreement are not accepted within 30 days of such notice.

XII. PROSECUTION OF UNLICENSED COMPETITION

In the event during the existence of this agreement there is any infringement by others of any patents granted on the applications or inventions herein licensed or agreed to be licensed to Kutol, it is agreed that Kutol shall have the sole right to proceed against such infringers. Upon notification to B & D thirty (30) days prior to filing such suit or taking other action as Kutol may deem advisable, Kutol may require B & D to participate in the yearly expenses of such suit or involved action to a maximum of 50% of the yearly expense involved or to the extent of the royalties paid to B & D during the preceeding calendar year, whichever is less. The proceeds of any damages that may be recovered as the result of such suits shall be shared in the same proportion as the expenses incurred by B & D and Kutol in the prosecution of such suits.

It is further agreed that, if after 30 days notice from B & D to Kutol that a party is infringing any of said patents, Kutol fails to bring suit against the infringing party, B & D may, at its option, take appropriate action, including suit, against such infringing party; and any monies recovered through B & D's sole action shall be the property of B & D.

XIII. TERMINATION

(a) If Kutol shall at any time default in the payment of any royalty or making of any report hereunder, or shall commit any breach of any covenant herein contained, or shall make any false report and shall fail to remedy any such default, breach or report within thirty (30) days after written notice thereof by B & D, at its option, B & D may terminate this agreement and the rights herein granted by notice in writing to such effect.

(b) At any time after one (1) year from the date of this agreement, Kutol shall have the right to terminate this agreement at the end of any calendar year, provided there is no default hereunder, by written notice given to B & D at least thirty (30) days prior to the end of such year. In the event that this agreement is brought to an end, either by termina-

tion, cancellation, discharge, or otherwise at the election of Kutol or upon or as a result of a breach of Kutol, Kutol agrees that it will not thereafter engage in the business of manufacturing or selling Extrusion Devices within the field or scope of this agreement as provided in Article I.

Following termination Kutol may reinstate this agreement by giving sixty (60) days notice to B & D provided that Kutol pays the minimum royalties which went unpaid during the period following termination and that the percentage basis for future royalty payments be based on a total of sales which includes the number Extrusion Devices sold while Kutol was previously operating under this agreement; and provided further that B & D has not entered into any contract, with a third party having exclusive provisions which would preclude Kutol's reinstating this contract. B & D agrees that it will not make any contract with a third party which would prevent Kutol's manufacture of Extrusion Devices after the normal expiration of this contract.

(c) In the event that Kutol shall demonstrate the existence of unlicensed competition materially interfering with its business hereunder, and the party or parties hereto are unable or unwilling to prevent or restrain such unlicensed competition, Kutol shall have the right to terminate this agreement and its license hereunder by written notice given to B & D at least thirty (30) days prior to such termination.

(d) Unless previously terminated in accordance with the foregoing provisions of this Article XIII, this agreement and the rights granted hereunder shall run to the full end of the term or terms of any Letters Patent that may issue on or as a result of the application or applications referred to in Article II hereof or for a period of 25 years, whichever is longer, and shall thereupon terminate.

XIV. PATENT INFRINGEMENT SEARCH

Licensors shall promptly, within thirty (30) days after the execution of this Agreement, cause a patent infringement search to be made by a reputable patent law firm in order to determine whether the within described Extrusion Device in its manufacturing, using, or selling would constitute an infringement on a previously issued patent. Upon the completion of such patent infringement search, the Licensors shall forthwith submit to Licensee the written professional opinion of such patent law firm which opinion shall advise as to the likelihood and/or probability that the manufacturing, using, and selling of said Extrusion Device would constitute an infringement of prior Letters Patent. The cost of such patent infringement search shall be borne equally by the Licensors and by the Licensee.

XV. LAW THAT GOVERNS

This agreement shall be construed in accordance with the law of the State of Ohio insofar as such law is existent or applicable and can or will be applied in the jurisdiction in which either party may seek adjudication of any such matter.

XVI. NOTICE

All notices provided for in this agreement shall be given in writing and may be served either by personal delivery or by depositing the same, postage prepaid, in the United States Registered Mails adressed to to parties respectively at the following addresses:

Kutol Products, Inc.
2815 Highland Avenue
Cincinnati 12, Ohio

Robert Boggild
5463 Hill & Dale Drive
Cincinnati 13, Ohio

or

William L. Dale
197 Ireland Ave.
Cincinnati 18, Ohio

or to such other address or addresses as Kutol or B & D respectively may later fix by written notice to the other.

XVII. LIABILITY

Kutol agrees to hold B & D harmless from any claims which arise by virtue of failure of materials or workmanship used in the production of Extrusion Devices covered by this agreement.

XVIII. MODIFICATION

This agreement is the entire and only agreement between the parties, and it supersedes all pre-existing agreements between such parties, respecting the subject matter hereof, and any representation, promise or condition in connection therewith and not incorporated herein shall not be binding upon either party. No modification, extension, waiver, and no termination of this agreement or any of the provisions herein contained shall be binding upon the party against whom enforcement of such modification, renewal, extension, waiver or termination is sought, unless made in writing and signed by the parties, or in the case of Kutol Products, Inc., by one of its executive officers. As used herein, the word "termination" includes any and all means of bringing to an end prior to its expiration by its own terms this agreement, or any provision thereof, whether by release, discharge, abandonment or otherwise.

IN TESTIMONY WHEREOF, the said Kutol Products, Inc., has caused its corporate seal to be hereunto affixed and duly attested and these presents to be signed by its proper of-

ficer hereunto duly authorized, and the said Robert Boggild and William L. Dale have hereunto set their hands.

KUTOL PRODUCTS, INC.

Witness: /s/ _____ By /s/ _____

(Title) (Seal)

Witness: /s/ _____ /s/ ROBERT BOGGILD

Witness: /s/ _____ /s/ WILLIAM L. DALE

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

ROBERT BOGGILD and WILLIAM L. DALE,
Plaintiffs,

vs.

KENNER PRODUCTS, A DIVISION OF
CPG PRODUCTS CORPORATION,
Defendant.

CASE NO. 83-638 (Civil Action)

DEPOSITION OF JOSEPH McVICKER

BE IT REMEMBERED that pursuant to Rule 27(b), and on Thursday, December 19, 1985, commencing at the hour of 9:00 a.m., at Quail Lodge, 8205 Valley Greens Drive, Carmel Valley, California 93923, before me, Joan Mitchell, CSR No. 2569, a Notary Public, personally appeared Joseph McVicker.

APPEARANCES

For Plaintiffs:

Messrs. SANTEN, SHAFFER & HUGHES
Attorneys at Law
105 East Fourth Street, Suite 916
Cincinnati, Ohio 45202
BY: WILLIAM B. SINGER, Esq.

For Defendant:

Messrs. MARSHALL, O'TOOLE, GERSTEIN,
MURRAY & BICKNELL
Attorneys at Law
2 First National Plaza
Chicago, Illinois 60603
BY: MADELINE HENDRICKS DEVEREAUX, Esq.

[1]

JOSEPH McVICKER,

being first duly sworn by the Notary Public to testify to the truth, the whole truth, and nothing but the truth, was examined and testified as follows:

EXAMINATION

BY MR. SINGER:

Q. Would you state your name sir?

A. Joseph Samuel McVicker.

Q. And what's your current address, Mr. McVicker?

A. 722, Carmel, California 93921.

Q. Are you currently employed, or retired, or what?

A. I'm currently doing seminars in England on the entrepreneur, and doing creativity workshops in Carmel.

Q. Just by way of a brief history, as I understand, you are the developer, or inventor, shall we say, of a product called Play-Doh; is that correct?

A. Yes.

Q. Could you, for the benefit — for the Trier of Fact in this case — give us, briefly, how it happened that you were able to develop this product called Play-Doh?

A. Play-Doh came from a product called Wallpaper, one word, Cleaner, which was a flour-based product used in the '40's to clean wallpaper inexpensively in the Midwest where there were lots of walls and dirt — Ohio, Illinois, et cetera, Pittsburgh.

[2] On the back of the can, it said, "Use as a modeling compound," but nobody ever did, and in 1955 I decided to do

that. And to do that, I changed the product and made it non-toxic, made it smell like cookies, and put it in pretty primary colors and went out to market it for the kids.

Q. And did you — during the course of your marketing, did your marketing efforts meet with some success?

A. Yes.

Q. And I'm talking now, initially, about a period prior to the time when you began to sell plastic toys along with it. Did you achieve a substantial success in the marketing of Play-Doh?

A. Yes, I think so. Yes, I mean I don't know, how do you define that? Sales were $31,000 the first three months, and I think 230 the next six months, and two million the next months.

Q. And as far as the product — strike that. What you are talking about in terms of the sales is the product Play-Doh alone; is that correct?

A. I was only in the bulk tonnage business of sellng a single toy, Play-Doh. Whatever facilitated that was okay.

Q. Okay.

A. And different packages. There was a three-pack, a four-pack. There were giant cans. Any way to sell [3] Play-Doh.

Q. Did you find that after the initial period of success in marketing Play-Doh that you needed something else to help sell Play-Doh, something to go with it?

MS. DEVEREAUX: I object to the leading nature of the question. I think Mr. McVicker is capable of answering his own questions in his own words.

BY MR. SINGER:

Q. Let me see. For purposes of argument, I'll accept that and we'll go and try to rephrase the question.

Mr. McVicker, did you, after initial success, find that you wanted something else to go with the marketing of Play-Doh?

A. Yes.

Q. And what was that?

A. Anything which would sell more Play-Doh. Cookie cutters, extrusion devices, merchandising ideas.

Q. Okay.

A. Play-Doh — there was a need for Play-Doh. It would be real nice to take credit for being a genius, but the fact is there was a basic need for this product with young preschool children. It was clean and safe, and it was inexpensive, and mothers made it at home for years.

Q. I. see.

A. But you have it all wrapped up in nice, pretty colors, [4] smelling good, for — then, 59 cents for four cans — something that was easier than making it at home and it didn't get sticky. So there was a lot of success because the need was already there. And we filled the purpose.

Q. How did you first come up with the idea of marketing toys along with Play-Doh?

A. I wanted to sell all the product I could, and there was a lot of pressure on the toy business so that things were — like the Hula Hoop — were fads. There were very few staples. Monopoly was one of them. But we had only been there three years, '55. By '58 the toy industry said, quote, "Look, you are going to be a fad and you are going to go out of business unless you add toys," and I said, "I want to sell Play-Doh." I said, "Find me things that use that product." That's how it worked.

Q. Okay. Now, how is it that you got involved with Boggild and Dale, what was the purpose of that association in the beginning?

A. They came to me to sell an idea for a toy which would use Play-Doh, and they came to my office in Norwood, N-o-r-w-o-o-d —

Q. Norwood, Ohio?

A. Yes, sorry.

Q. And what did they offer you at that time? What was [5] the idea?

A. They had an extrusion device that looked like a red schoolhouse called the Fun Factory. It wasn't called anything. They had an extrusion device with a plunger and configuration that looked like a schoolhouse, and interchangeable dies, and by putting the Play-Doh in the schoolhouse and

pumping the handle, you were able to extrude it like an old-fashioned cookie cutter. And the idea had a lot of appeal to me, so I went to work to make a deal.

Q. And you initially entered into a license agreement with the particular extrusion device; is that correct?

A. Yes.

Q. Now, let me just ask you in general, with respect to your relationship with Boggild and Dale, how were they to be compensated for any ideas that they would come up with?

A. We made a contract to pay them a royalty on every device sold.

Q. Did you ever —

A. It was a comprehensive agreement.

Q. Did you ever pay them just to come up with ideas?

A. No, no. My idea was that I'm doing you a favor and you are helping me, but I've got to take the risk of putting this out on the market; and, therefore, this is what I want you to do, in the contract.

[6] Q. In terms of the development of ideas, in terms of engineering and things of that nature, would they ever be paid for just those services?

A. No. My idea was a flat royalty with a graduated basis based on how many units are sold, and for this contract, you have to do the following: You try to get whatever legal protection you can. You render all the technical assistance that you can because I'm a marketer. I don't know how to do this and I don't want to be messing with dies and molds and plastic, and so part of your deal with me is you are going to have to take care of all that and you've got to be available for emergencies if I'm in England or someplace and, say, the handle's broken. You've got to fix it.

Q. I see. Now, the initial Fun Factory that you mentioned — and let me back up a minute. You began to identify the extrusion device that looked like a schoolhouse, as the Fun Factory. Is that the name that it finally was marketed under?

A. Yes, it was marketed as the Fun Factory.

Q. Okay.

A. There was a later one, a smaller version that was called the Fun Factory, Jr.

Q. That's what I wanted to get to. From that initial Fun Factory device then, there was a later evolution [7] to a smaller device called the Fun Factory, Jr.; am I right?

A. Yes.

Q. And would you describe the Fun Factory, Jr. — and by the way, I might indicate that that is the particular device that is the subject matter of this litigation —

A. The first one was larger, and while it had great appeal to me, the second one was smaller and less expensive at retail. I don't know, maybe $3.00 versus five. It had — I thought I could sell more of them because it was less expensive and it was less cumbersome. It was a technical improvement. Instead of a plunger and separate parts, you had it all in one handle. Isn't that the way it worked? It's been a long time.

Q. Was it safer for children to use?

A. Oh, yes, much easier, and you didn't break handles. The technical aspect didn't cause me any problems and increased the market.

Q. Did — I guess at some point Mr. Boggild and Mr. Dale brought you the idea for the Fun Factory, Jr.?

A. All the ideas for the toys were brought to me.

Q. And did they disclose it to you in confidence?

A. I think — I think after the first one, I had a bad experience. I had signed a confidential disclosure several years before with a man named Marvin Glass, [8] on an extrusion device to use Play-Doh. When he heard of the Fun Factory, he sued me for violation, and he lost. So I was careful about words like that.

Q. Okay. In any event, they disclosed this device?

A. They brought it — I think they came into my office with their idea and I liked it and bought it and made the agreement. And they did the same thing with the Fun Factory, Jr.

Q. We're talking now about the Fun Factory, Jr., when they brought it to you?

A. They brought it to me.

Q. Did you like the device?

A. Yes.

Q. And did you want to market it?

A. Yes.

Q. Okay. What — Let me show you what's been marked as Plaintiff's Exhibit Number 1, Mr. McVicker, and ask you if you can recognize what that is a copy of.

A. Yes, this is an agreement between Boggild and Dale and Kutol, K-u-t-o-l, Products.

Q. What is Kutol Products?

A. It was the manufacturing company — Rainbow Crafts was the marketing company, and Kutol was the manufacturing company. I own both of them.

Q. Kutol was the company that manufactured —

A. They were effective financial tools for me to have [9] two companies.

Q. But Kutol was the company which manufactured Play-Doh?

A. Yes. So the agreement was between Kutol and Boggild.

Q. If you look on the last page of this Exhibit 1, you see a copy of your signature there?

A. I do.

Q. All right. In terms of the provisions of this agreement, did you negotiate those provisions with Messrs. Boggild and Dale?

A. Yes. Primarily with Bob Boggild when Dale was present, but Boggild and I did most of the working out of the agreement.

Q. What role, if any, did attorneys play in negotiations and the formation of agreements?

A. My attorneys were Taft, Stennins & Hollister, and they approved the contract and got any terms — you know, they wrote up — I think his attorney and mine, but they didn't have anything to answer specifically. The didn't have anything to do with negotiations.

When I made the deal I wanted with Boggild, I asked them

to translate it legally and to check with his attorney if it was okay. The attorneys gave legal approbation, that's all.

Q. What was your object in negotiating this agreement with Boggild and Dale? What was your objective?

[10] A. Sell Play-Doh.

Q. I see. And —

A. And make money, you know, but they were the same to me.

Q. Let me ask you whether or not the patent protection, or the potential of patent protection, played a significant role in your negotiations?

MS. DEVEREAUX: I object to the extent that I don't understand what you mean by "significant." Obviously, if Mr. McVicker understands what you mean by it, he's free to answer whatever he understands.

BY MR. SINGER:

Q. Let me rephrase the question, Mr. McVicker. The agreement contains certain provisions with respect to patent and patent applications. Given that, can you tell us what, if any, role the expectation that a patent might issue for this device played in your willingness to pay royalties for the use of the device?

A. That's a long question. Please rephrase it simply for me.

Q. Let me try.

Did the likelihood that this device would be patented affect your desire to pay royalties for it?

A. No, I couldn't wait for that. That patent process is lengthy, and, I think, fairly worthless. It took me nine years to get a patent on Play-Doh. I don't [11] know how long it took to get a Fun Factory, Jr., patent, but if I waited for that, someone else may have invented a toy to take its place or — so, I went out and marketed — I went out and sold it to Toy Fair by January. By March, I had this in all the toy catalogs.

Q. When did you have — did you have any idea when you signed that agreement, that this toy was going to be patented?

A. I didn't know, I certainly asked, after this bad experience that I had if I would be protected any way I could be protected, and they should at least see if they could get a patent protection, and protection is an additive, but it's not determinative for me. What determines it is, can I sell it, and can I get it to the market first?

Q. Did the likelihood or the expectation that patents would issue for this device in any way affect your willingness to pay royalties for a term of at least 25 years?

A. Say it again so I can answer the question.

Q. The period of this agreement, as it's stated in — let me see if I can find it.

Okay. On Page 14 of Exhibit 1, the paragraph D, which appears in the middle of that page, if I'm correct, provides for a minimum period of 25 years —

A. That's right.

[12] Q. — of the royalty obligation.

A. Right.

Q. Did the thought that this device may be patentable influence, in any way, your desire to pay royalties for the use of the device and to pay those royalties for that period of time?

A. The patent and the application and the assertion of the patent, and the possible issuance of a patent, did not determine my making a deal with Boggild. What determined it was a whole package, which included their giving me technical and manufacturing assistance, solving manufacturing problems, taking responsibility to search infringement, the cost of filing for an application and seeing it through without any cost or liability to me; and that's the deal I made with them.

Q. In general, Mr. McVicker, what had your experience been, prior to 1963, with respect to the efficacy of the patent protection?

A. I didn't have a patent on Play-Doh. I filed it in '55 or '56 and I got in in '64, and under duress from my employees to get protection. I think the only protection is marketing dominence. If you are there, where somebody else isn't; if the patent comes along, it's an additive and it's a nice one, but it's

not to be depended upon to make a [13] profit or to market the product.

Q. Okay.

A. It is a potential protection, but only potential, depending on the intricacies of the patent law and the skill of the inventor in convincing the patent office of its uniqueness.

Q. Did you, during the course of time that your patent application was pending for Play-Doh, have occasion to deal with competitors in that product?

A. Yes.

Q. And how —

A. I had two competitors, one product called Kid-Dough, in Cleveland, Ohio, and another called Fun-Dough in St. Louis. They were both produced by manufacturers of wallpaper cleaners, which is what we were originally, and they were older gentlemen and they both tried to compete unsuccessfully.

Q. How did you achieve your dominence in that product —

A. Marketing.

Q. — briefly?

A. Marketing. By putting it in the schools — I'll tell you how.

I went to New York City with a can of Play-Doh in my hand, and walked into NBC and walked up to whatever floor — to the Ding-Dong School, which was [14] before Captain Kangaroo, which — who's been on longer than Nixon — and walked onto the set and said, "Here, I've got this great product," and somehow the woman, Dr. Horowitz, accepted it — Miss Frances — and then I got calls from agents saying, "You can't do that. You've got to have a contract and you've got to pay royalties," and whatever; so I made a contract in Beverly Hills, California, for what I had already done in New York, and paid five percent in order to have national exposure on national television; and that's the thing I did.

Another thing was going to schools and convincing the school teachers they could have free Play-Doh for these poor kids. Another was getting the Parents Seal of Approval.

Another was buying television spots in Evansville, Indiana. Another was going to England in 1957, when I didn't have distribution in the Midwest; but I was going to put this all over the world. That was my idea.

Q. I take it from the fact that during this period of time you did not have patents, that patents did not contribute, or the potential patentability did not have —

MS. DEVEREAUX: Objection, leading.

BY MR. SINGER:

Q. Let me ask you, Mr. McVicker — I'll rephrase the [15] question.

THE WITNESS: I agree with you.

MR. SINGER: I agree with her, too.

THE WITNESS: I agree with you.

BY MR. SINGER:

Q. I didn't do that deliberately, but sometimes we fall into that.

Did the patentability, or not, or the existence of patents or not, with respect to Play-Doh, in any way add to or detract from its marketing success?

A. Potentially added to. Potentially added to say "Patent Applied For," but in actuality it didn't do anything until the patent was issued. So the promise of a patent was not the equivalent to having a good patent issued. The potential — I mean we didn't have anything. The reason the Fun Factory sold is because we put it out there with a good product. The reason we put the next one out is because the first one sold, and we were smarter, and on the next one, there was a contract patent search, and infringement and protection were part of the total contract all along, and of more importance to me was technical stuff, assistance. And even more important to me, as I'm sitting here, having read it again this morning, I hedged my bet by graduating the royalties.

Q. I see. Let me ask you about that. The agreement [16] provides that royalties — let's get the exact provision.

Again on Page 6 of the Exhibit 1, Paragraph 6F(1) provides for graduated royalties. What was your idea in providing for graduated royalties at that time?

A. I wanted the minimum risk and the minimum cost because the cost of marketing a product was substantial and I wanted to see if the product was substantial and I wanted to see if the product would sell. I wanted to — I wanted Boggild and Dale to be cooperative and not create problems, but facilitate my objectives, which was to put a can of Play-Doh in every kid's hand in the world.

Q. In terms of, then, the graduation of the royalties, the agreement does not say that the graduation of royalties, the increase of royalties, the percentage of royalties, is contingent upon the issuance, or not, of a patent?

Let me ask whether or not that's consistent with your view of the importance of patents in this negotiation process?

MS. DEVEREAUX: I object to the question. I don't understand it at all and I don't know how you would intend to use it if you ever got the opportunity. And I'm — so I don't know what the meaning of any answer to that he's going to give, would be, because [17] I truly cannot understand the question.

MR. SINGER: Well, then, let me just ask Mr. McVicker to answer the question if he understands it.

THE WITNESS: Could you read it back?

BY MR. SINGER:

Q. Let me rephrase it, because I think it was perhaps a bit clouded.

In agreeing to graduated royalties, was it the increase in sales that influenced your willingness to pay a higher royalty rate?

MS. DEVEREAUX: I still object. I mean, why don't you ask him what it was that influenced his willingness to pay a higher royalty rate, instead of trying to put words and suggestions in his mouth?

MR. SINGER: I'll take your suggestion.

BY MR. SINGER:

Q. What was it, Mr. McVicker, that influenced you to agree to increase the royalty rate? What was it that it was contingent upon?

A. Success.

Q. Okay. Did patent have anything to do with it?

A. Patents were simply applied for. They weren't issued.

Q. Okay.

A. I'm not acquainted with what your legal arguments are about. I'm saying the Fun Factory helped sell [18] Play-Doh. I wanted to minimize what I was paying, until I could perceive that it was a good item. I was quite willing, when I had made my sales of the Fun Factory, to share; but I was asking with the initial outlay of designs, molds, marketing, if they would minimize — obviously I was saying, "Hey, you trust me, I'm a good marketer. If I make money, you'll make money." And they bought that and, you know, that was part of the contract, and all they said is, "Listen, can we have at least a thousand dollars a year?" or something. There was some minimum. I don't remember whether it was $10,000 or $1,000. Okay. There was some minimum, and since I had no development costs, since I didn't have to do anything but dial 911 to get the hotline if I had a problem, since they were going to apply for a patent infringement so I wouldn't get sued by Marvin Glass again for confidential disclosure, that was the whole package, and, based on a trend — am I allowed to tell a story off the record?

A man jumped out of the 32nd floor of the Empire State Building. At the 31st floor, he passed a man at a window of the Empire State Building, who said, "How is it going?" He said, "So far, so good, but the trend is bad."

Now, the trend of the Fun Factory was good; [19] therefore, I was willing to pay, based on the trend.

Q. All right. Mr. McVicker, when you — it's in the patent infringement search, and there is a provision to this agreement that provides that there should be a patent infringement search?

A. Right.

Q. Let me ask you whether or not that — well, strike that.

Let me ask you very simply, what was the purpose, from your point of view, of having a patent infringement search with respect to this device?

A. I wanted everything I could get. I wanted protection, if I could get it. I wanted the — no liability. Remember, I'd been in a lawsuit over a confidential disclosure on an extrusion device, and I didn't want to do that again. I didn't want to get into any legal liability. It's quite similar to the — asking for my deposition and that's fine with me that this is on the record.

Q. What I'm saying to you is asking you your — was it your purpose in wanting a patent infringement search to determine whether or not this product would be patentable, or was it to determine whether or not, if you marketed the device, you would get potentially sued by somebody else who claimed the device?.

A. I think it's both. I can't separate them. It was [20] to protect me from liability and it was to add to my success with the Fun Factory if we could get a patent.

Q. Did the —

A. The momentum was not created by the patent. It was created by the market, but I asked for everything I could get in the market, minimal cost, technical assistance, patent search, patent application.

Q. Okay. Well, let's talk about, then — specifically with reference to the royalty terms, Mr. McVicker. In negotiating the royalty terms, did you assume any degree of likelihood that valid patents would issue?

A. Did I assume that?

Q. In other words, did you have any — let's make it simpler.

Did you have any idea whether or not patents would issue at the time you negotiated?

A. No, I didn't know that.

Q. Okay. Did it — in terms of your willingness to pay the royalties, all right, did whether or not patents issued affect your willingness to pay royalties?

A. No.

Q. Did whether or not patents issued affect your willingness to pay royalties for a minimum twenty-five year term?

A. No. I made a deal to sell this toy. I made a contract.

[21] Q. Now, Mr. McVicker, let me draw your attention to Article VI G, Good, of the agreement, which is on Page 7, and ask you whether or not that paragraph expresses in this agreement what you have just testified to?

A. Yeah, it's agreed that we pay whether the filing happens or not. That's what it says here.

MR. SINGER: All right. That's all the questions I have, Mr. McVicker.

You may cross-examine.

EXAMINATION

BY MS. DEVEREAUX:

Q. Mr. McVicker, I would like for you to look at the paragraph that begins at the bottom of Page 13, in the small c — with a small c, Article 13 of the contract.

Have you had an opportunity to read it?

A. Yeah, I have.

Q. All right. Now, as I understand, as I read that language at least, that provides that in the event you experienced unlicensed competition that was affecting your business, I take it that's the business of selling the Fun Factory, Jr., that the parties were unwilling or unable to prevent or restrain, you had the right to terminate the agreement?

A. That's right. That's what it says.

[22] Q. Do you understand why that provision was included in the agreement.

A. I understand why I included it.

Q. Why is that?

A. I included it because I didn't want them to sell it to somebody else. I wanted to be the source of it.

Q. Was exclusivity in selling important to you then?

A. The maximum protection, and certainly the major part of that was being the only manufacturer of this item — that was part of it.

I'm talking about an exclusive right to sell.

Q. Did you —

MR. SINGER: Excuse me. The witness is explaining his answer and he hasn't finished his answer.

THE WITNESS: I'm just saying I had a — is this a debate, Counselor? — exclusive right to sell, is what I wanted.

MS. DEVEREAUX: I wasn't intending to interrupt the witness and I resent your implication that I was. It's my understanding that he paused and was finished. I'm sorry.

BY MS. DEVEREAUX:

Q. Did you understand at that time that an issue of patent would give you the right to exclude others from selling the Fun Factory, Jr.?

A. I didn't have any confidence, Mrs. Devereaux, in [23] patents, but I tried to apply for one. I did not know when and if they would issue and how — how strong and how willing I would be to defend them if they did issue. I asked for everything. I asked for all the legal protection I could get and I asked for Boggild and Dale not to diffuse my efforts in marketing by having other people market the product. I mean, if tires were an exclusive, it would be an incredible monopoly, you know. If one company, Goodyear, Goodrich or somebody, were only able to make tires, it would change their position.

Q. All right.

A. To at least not to have to compete with other people on the same toy could help my position, and to apply for a patent was — patent was one of the ways to help do that; but it was not the only way.

MS. DEVEREAUX: I have no further questions.

MR. SINGER: Nor do I.

Thank you Mr. McVicker. Thank you Counsel.

WITNESS

[Jurat Omitted]

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